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Supreme Court of the United States

OCTOBER TERM, 1959

MANSFIELD HARDWOOD LUMBER COMPANY,

Petitioner

versus

HATTIE A. JOHNSON; JEANETTE JOHNSON JENNETTE; CORA HARREL, Administratrix of the Estate of Mamie E. Harrel; J. A. HARREL; ELIZABETH HARREL WALKER; RUTH HARREL MULKEY; MAX BROWN; ALICE S. H. BROWN; and DREW VELVIN, Executor of the Estate of Minnette Velvin,

Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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August, 1959

LECOMTE, SHREVEPORT, LOUISIANA

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(B) In declining to follow a controlling decision of this Court and deciding the case in a contrary manner because of its views as to what the law ought to be.

(C) In rendering an opinion on application for rehearing which admittedly reversed the basis of its prior opinion on the merits and resolved the case upon a different basis without affording the applicant an opportunity to be heard.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner, Mansfield Hardwood Lumber Company, prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered on February 20, 1959 (Appendix, p. 128).

OPINIONS BELOW

The opinion of the District Court on pending motions and application for preliminary injunction (Appendix, p. 1) is reported at *143 F. Supp. 826.* The ruling of the District Court on pending motions (Appendix, p. 32), its supplemental reasons for rulings (Appendix, p. 34), and its ruling on defendant's motion to compel answers (Appendix, p. 40) are not reported. The opinion

of the District Court on the merits (Appendix, p. 52) is reported at *159 F. Supp. 104*. The opinion of the Court of Appeals for the Fifth Circuit on the application for preliminary injunction (Appendix, p. 43) is reported at *242 F. (2d) 45*, its opinion on the merits entered February 20, 1959, (Appendix, p. 111) is reported at *263 F. (2d) 748*, its opinion denying petitioner's application for rehearing (Appendix, p. 129) is as yet unreported.

JURISDICTION

The judgment of the Court of Appeals was dated and entered February 20, 1959 (R. 1685). Petition for rehearing filed April 9, 1959 (R. 1689), pursuant to an order filed February 26, 1959, extending the time for its filing to April 11, 1959 (R. 1686-8), was denied June 16, 1959, in an opinion of the same date. The jurisdiction of this Court is invoked under *28 U. S. C. 1254(1)*.

QUESTIONS PRESENTED

In this diversity case filed in Louisiana by former stockholders against a Delaware corporation in liquidation on allegations that the purchase of their stock by the Corporation and subsequent liquidation thereof was planned by the Corporation's officers for their own personal gain, and the relief sought was rescission of the stock sales, an acounting and a pro rata distribution of the corporate assets, the following questions are presented:

1. Whether the Court of Appeals had the right or the power to apply the laws of the forum (Louisiana) to determine the nature and extent of obligations between the officers and stockholders of a foreign (Delaware) corporation, inter sese, in direct conflict with applicable decisions of the Courts of Appeals for the Second, Third and District of Columbia Circuits and of this Court in *Rogers v. Guaranty Trust Co., 288 U. S. 123*, which required the Court to apply the laws of the state of in-

corporation, by declaring that those decisions are "unsound" and by declaring actions of the corporation's officers, which it found were legal and proper under the laws of Delaware, to be a breach of fiduciary obligations and fraudulent under its conception of the laws of Louisiana.

2. Where the Court, by a mandatory preliminary injunction, irrevocably divested the corporation, the sole defendant, of its every remaining asset by transferring title thereto to a Trustee-Bank with no authority to defend this action, pending its determination of the ownership of said assets as between the former stockholders and the remaining stockholders of the corporation, whether the Trustee-Bank, as holder of the legal title to the assets, the remaining stockholders of the corporation, the alleged wrongdoing officers, or any of them, are indispensable parties to the action(1).

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(1) The following questions are those which petitioner desires to preserve and raise if Certiorari is granted:

A. Whether there is any actual fraud in this case which would authorize judgment for respondents in view of the finding by the Court of Appeals, "after a careful review of all of the evidence in this case", that the corporation's officers had no fraudulent intent and that the factual findings of the District Court were "clearly erroneous" (Appendix, p. 118), and specifically whether respondents Max Brown and Ben Drew Velvin, who testified there was no fraud (R. 415, 416, 433, 731), and respondents Mrs. Hattie A. Johnson and Mrs. Jeanette Johnson Jennette, who, with full knowledge of the basis of their claims of fraud, demanded full compliance with their sales contract (R. 533, 561) and accepted payment of the balance due three days after this action was filed (R. 288, 289, 561) are entitled to judgment rescinding the sales of their stock despite their testimony and despite the fact that they are barred by an election of remedies.

B. Whether the Court could determine that the purchase price paid for respondents' stock was inadequate on a theory that it *would have been* worth more on liquidation of the corporation two years after the sales took place and after an important change in the tax laws (Appendix, p. 116) where the only evidence in the case shows that respondents re-

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The pertinent provisions of the Fifth Amendment to the Constitution of the United States are as follows:

> "No person shall*** be deprived of life, liberty, or property, without due process of law;***"

The pertinent provisions of Article 1847 of the Louisiana Civil Code are as follows:

> "Fraud, as applied to contracts, is the cause of an error bearing on a material part of the contract, created or continued by artifice, with design to obtain some unjust advantages to the one party, or to cause an inconvenience or loss to the other. From which definition are drawn the following rules:
>
> * * * * *
>
> 7. The artifice must be designed to obtain either an unjust advantage to the party for whose benefit the artifice is carried on, or a loss or inconvenience to him against whom it is practiced, although attended with advantage to no one.
>
> * * * * * * *"

The pertinent provisions of 26 U. S. C. 337 (a) are as follows:

> "(a) General rule. — If —
>
> (1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and
>
> (2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of

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ceived more than the *fair market value* of their stock *at the date of the sales* (R. 417, 679).

C. Whether rescission of the stock sales and an accounting were rendered impossible by the complete liquidation of the corporation, the sole defendant, and irrevocable divestiture of its every asset, when restoration of the status quo would admittedly invoke a tax loss of approximately $1,500,000.00.

the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period."

STATEMENT

Filed in the Federal Court for the Western District of Louisiana on the basis of diversity of citizenship, respondents being citizens of Arkansas and Louisiana and petitioner a Delaware corporation, the action is one to rescind the sales of respondents' stock to petitioner, for an accounting and judgment against petitioner for a portion of its property, on allegations of a conspiracy of its officers to defraud. The decision below, which involves from petitioner's standpoint an amount approximating $3,000,000.00 and the possibility of a tax loss of an additional $1,500,000.00, presents conflict-of-laws and jurisdictional questions of importance to every corporation in this country doing business in more than one state.

Although the complaint sets forth a classic situation calling for a derivative action, alleging that the purchase of respondents' stock and thereafter the complete liquidation of petitioner was planned by petitioner's officers for their own personal gain, the alleged wrongdoing officers were not made parties. The sole defendant is the corporation which was in the process of liquidation when the action was filed. Petitioner's contention that its liquidators, the alleged wrongdoing officers and its stockholders were indispensable parties and that the action could not proceed against petitioner alone was overruled.

Prior to trial on the merits, the District Court, in order to complete petitioner's liquidation, by mandatory injunction irrevocably divested it of its every remaining asset and transferred said assets to a trustee-bank, to be held by it as stakeholder pending the determination

by the Court of the ownership thereof by respondents or petitioner's remaining stockholders, the latter not being parties to the action. This complete liquidation of petitioner and irrevocable divestiture of its assets was affirmed by the Court of Appeals for the Fifth Circuit. Petitioner's contention after the injunction that the trustee-bank as well as its remaining stockholders, whose title to the assets was thus put at stake, were indispensable parties was overruled by both Courts.

After trial on the merits, petitioner's officers were found guilty of actual fraud and judgment was rendered rescinding the stock sales and ordering an accounting. In an opinion refusing a new trial, the District Court admitted that its factual findings were erroneous in important respects but refused to reconsider the matter. On appeal, the Court of Appeals held that the District Court was "clearly erroneous" in its findings of actual fraud. However, it found that the results were correctly predicated on the theory of *constructive* fraud and affirmed. It found that a breach of fiduciary obligations by petitioner's officers furnished the basis for the imposition of a "constructive trust" or "equitable lien". An application for rehearing was filed.

In a complete reversal of the basis of its prior holding and without affording petitioner an opportunity to be heard on the subject, the Court of Appeals rendered an opinion refusing a rehearing wherein it stated that it would attempt to clarify and *correct* its prior opinion on the merits. It found that constructive fraud is impossible in Louisiana because intent is required as an essential element of fraud by the provisions of the Louisiana Civil Code, and that the Louisiana Civil Law prohibits the imposition of a constructive trust or equitable lien on property. Without in any manner reinstating the District Court's factual findings of actual fraud, it predicated its opinion upon a finding that in Louisiana the breach of fiduciary duties "is called fraud". Thus, the only

"fraud" found by the Court of Appeals was based upon a breach of fiduciary duties by petitioner's officers(2) and the entire case was narrowed down by the Court to the question of determining, in the first place, whether a fiduciary duty to disclose existed. The Court of Appeals found that Delaware, the State of petitioner's incorporation, imposes *no* fiduciary duty on corporate officers in purchasing the stock of individual stockholders. After erroneously stating that the Louisiana conflict-of-laws rule on the subject is silent, it found that under the general conflict-of-laws rule prevailing in this country, as set forth in the decision of this Court in *Rogers v. Guaranty Trust Co., 288 U. S. 123*, and decisions of the Courts of Appeals for the Second, Third and District of Columbia Circuits, the law of the state of incorporation determines the existence or non-existence of fiduciary obligations between

(2) The Court below, in its opinion refusing rehearing, used this language:

> "As stated earlier, the equitable remedies of constructive trust or equitable lien are alien to the civil law. Without these remedies and with the rule that "constructive fraud", found in the law of fiduciaries and characterized by the lack of the "intent to defraud", is impossible under Article 1847, Louisiana courts have an awkward time imposing liability for ***the breach of a fiduciary's duty*** to disclose or ***the breach of other fiduciary relations***. In some cases involving a relationship of confidence between the parties, the Louisiana courts have used the terms of common-law equity, ordinarily obnoxious to the civil law, to describe ***the breach*** and remedy for ***breach of fiduciary duty***, such as, "breach of trust" and "constructive trust". Normally, however, the Louisiana courts, in finding liability for ***a breach of a fiduciary duty***, have based such liability on "fraud" as encompassed in Article 1847 of the Civil Code. This is true in cases involving both corporate fiduciaries and other fiduciaries. Therefore, ***the breach of the relationship*** is called fraud and the remedy is, of course, a rescission of the contract or damages." (Appendix p. 137).

Italics have been added throughout the above findings to show that the decision is predicated upon the breach of fiduciary duties of petitioner's officers.

the officers of a corporation and its stockholders. It then stated that "in strict logic—and if literal compliance is given to those decisions—*the opinion is faulty*", but found that "those decisions are, however, in our opinion, either inapplicable or unsound" and that "where *all* contact points are in the forum, the laws of the forum (Louisiana) should govern". (Appendix p. 135)

REASONS FOR GRANTING THE WRIT

I.

IN HOLDING THAT THE EXISTENCE AND EXTENT OF FIDUCIARY OBLIGATIONS BETWEEN OFFICERS AND STOCKHOLDERS OF A DELAWARE CORPORATION SHOULD BE DETERMINED BY THE LAWS OF LOUISIANA (THE FORUM), THE COURT BELOW CAME INTO CONFLICT WITH DECISIONS OF THE COURTS OF APPEALS FOR THE SECOND, THIRD AND DISTRICT OF COLUMBIA CIRCUITS AND WITH AN APPLICABLE DECISION OF THIS COURT.

Although the decision below is predicated upon a breach of fiduciary duties between petitioner's officers and respondents, its former stockholders, in the purchase of their stock, the Court of Appeals correctly held that Delaware, the State of petitioner's incorporation, imposes *no* fiduciary duty on the part of officers or directors or majority stockholders in buying stock from individual stockholders. It cited Delaware cases on the subject and stated that this result has been uniformly followed by federal courts in interpreting the Delaware law. (Appendix p. 133). It likewise recognized that the Delaware rule in this conection is followed by a majority of jurisdictions in this country (3) but stated that the rule in

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(3) In *Stevens, Handbook on the Law of Private Corporations, 2d Ed. 1949, Sec. 159*, the following statement appears:

"According to what has been the weight of authority, a director is not obligated to disclose to an individual shareholder, before purchasing his shares, the director's information as to facts relating to the corporate business which will affect the value of the shares;

Delaware is "inequitable" (Appendix p. 137) and that this majority rule is "harsh" (Appendix p. 132). The Court of Appeals also found that a "growing minority" of jurisdictions, including Louisiana, recognize the existence of a fiduciary relationship inuring from officers and directors and majority shareholders to individual shareholders in purchasing their stock, and cited authorities to the effect that this minority rule is "the better rule". (Appendix p. 132). The Court then stated:

> "The next question presented is which law should determine this relationship—that of Delaware or Louisiana?" (Appendix p. 132)

In resolving this question, and in deciding that "we believe that the laws of the forum (Louisiana) should govern", the Court of Appeals rendered a decision in direct conflict with decisions of the Courts of Appeals for the Second, Third and District of Columbia Circuits and with the decision of this Court in *Rogers v. Guaranty Trust Co., supra.* This conflict is set forth *in the decision below* itself in the following language:

> "While Louisiana conflict-of-law is silent on which law determines whether such a fiduciary relationship exists in a foreign corporation, its various conflict-of-laws rules are generally the same as in other states. Therefore, we must look to the general law.
>
> "A number of cases have held that the conflict-of-laws rules of the forum require that court to refer to the 'law' of the State of incorporation to determine the extent and nature of relationship between corporation and stockholder, corporate officer or director and stockholder and between stockholders inter sese', (footnote 6) while the law of the place of the wrong determines the quantum of the breach

> ***the director's fiduciary relationship, it is said, is toward the corporation and in respect to its property and its business,*** but the director is in no fiduciary relation toward individual shareholders with respect to their shares." (Emphasis supplied).

of duty. Apparently, Delaware imposes no fiduciary duty on the part of officers or directors or majority shareholders in buying stock from the minority or individual shareholders. In strict logic, a strong case is made that, if this Court's opinion is based exclusively on the breach of fiduciary obligations owed by directors and majority stockholders of a foreign corporation to minority stockholders, and if literal compliance is given to those decisions holding that the State of incorporation sets the standards for all personal relationships between persons connected with the corporation, *the opinion is faulty.*

"Those decisions (listed in footnote 6, supra,) are, however, in our opinion, either *inapplicable or unsound*—". (Appendix p. 132, emphasis supplied)

In footnote 6 the Court of Appeals listed the decisions from the Second, Third and District of Columbia Circuits and this Court which hold that the existence of fiduciary obligations between the officers and stockholders of a foreign corporation must be determined by the laws of the State of incorporation, setting forth specific page references therein, as follows:

"Zahn v. Transamerica Corporation, 3rd Cir. 1947, 162 F. 2d 36, 40. See also, Rogers v. Guaranty Trust Co., 1933, 288 U. S. 123, 130; Perlman v. Feldmann, 2d Cir. 1955, 219 F. 2d 173, 175; Mayflower Hotel Stock P. Com. v. Mayflower Hotel Corp., D. C. Cir. 1951, 193 F. 2d 666, 668; Maxwell v. Enterprise Wall Paper Mfg. Co., 3rd. Cir. 1942, 131 F. 2d 400, 402; Geller v. Transamerica Corp., D. Del. 1943, 53 F. Supp. 625, 629-630; aff'd 151 F. 2d 534; Hirshhorn v. Mine Safety Appliance Co., W.D.Pa. 1952, 106 F. Supp. 594, 600; aff'd 203 F. 2d 279; Fayes, Inc. v. Kline, S.D.N.Y. 1955, 136 F. Supp. 871, 872."

The holding by this Court in *Rogers v. Guaranty Trust Co.*, referred to by the Court below in this footnote and followed by the other Courts of Appeals, *288 U. S. at page 130*, is a follows:

> "When, by acquisition of his stock, plaintiff became a member of the corporation, he, like every other stockholder, impliedly agreed that in respect to its internal affairs the company was to be governed by the laws of the State in which it was organized. His rights, *whatever the tribunal chosen for their vindication*, are to be determined upon the ascertainment and proper application of New Jersey law." (Emphasis supplied)

It is axiomatic that the laws of the State of incorporation govern the internal affairs of a corporation, including the powers and obligations of its officers and stockholders inter sese. In *Broderick v. Rosner, 294 U. S. 629, 643-644*, this Court held:

> "The act of becoming a member of a corporation is something more than a contract, it is entering into a complex and abiding relation, and as marriage looks to domicile, membership looks to and *must be governed by the laws of the State granting the incorporation.*" (Emphasis supplied)

In *Canada Southern R. Co. v. Gebhard, 109 U. S. 527*, this Court held:

> "A corporation 'must dwell in the place of its creation, and cannot migrate to another sovereignty,' though it may do business in all places where its charter allows and local laws do not forbid. But wherever it goes for business it carries its charter, as that is the law of its existence. Whatever disabilities are placed upon the corporation at home it retains abroad, and whatever legislative control it is subjected to at home must be recognized and submitted to by those who deal with it elsewhere.** It follows, therefore, that anything done at the legal home of the corporation under the authority of such laws, which discharges it from liability there, discharges it everywhere."

The fundamental conflict-of-laws principle, that the existence and extent of obligations between the officers and stockholders of a foreign corporation are determined by the laws of the state of incorporation, is announced in

the *Restatement, Conflict of Laws, Sections 197 (a) and 199.*

Nevertheless, the Court of Appeals below, refusing to follow the authorities on the subject, set forth an unsupported exception to the general law in the following language:

> "When, however, the situation is [illegible] as here, where neither the charter nor the statutory laws of the incorporating state are applicable, and *all* contact points are in the forum, we believe that the laws of the forum should govern." (Appendix p. 135, emphasis by the Court) (4)

By referring to "contact points" as the basis for applying the laws of the forum, the Court below has rendered a decision in direct conflict with the decision of the Court of Appeals for the Second Circuit in *Harr v. Pioneer Mechanical Corp., 1933, 65 F. 2d 332, 334.* In that case the Court emphasized that because the main office of a Delaware corporation was located in New York and all business was conducted there, the Federal Court in New York could take jurisdiction of the case, but held that, having taken jurisdiction, it was bound to give effect to and apply the laws of *Delaware* to determine the rights of the stockholders inter sese and other internal affairs of the corporation.

In holding that the internal affairs of a foreign corporation may be governed by the laws of the forum, the decision below is of importance to every corporation in this country doing business in more than one state,

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(4) In addition to the fact that the statement is factually erroneous, the novel position of the Court below is supported by no real authority. Mere reference to the Louisiana Pocket Supplement, *Restatement, Conflict of Laws, Section 257 and Comment a.* reveals the notation that the law in Louisiana is "contra". In *Blazer v. Black, 196 F. 2d 139,* the questions here involved were not even raised or discussed. The *Mayflower Hotel Corp.* case, *supra,* was cited by the Court below in its footnote 6 in support of the opposite conclusion.

and particularly corporations chartered under the laws of Delaware. Heretofore, the laws of the state of incorporation have governed the rights and obligations of the officers and stockholders wherever the corporation has conducted its business. Anything done under authority of the corporation's home state, which discharged it from liability there, has discharged it from liability elsewhere. If the decision in this case is allowed to stand and the internal affairs of foreign corporations are to be determined by the laws of the forum, the danger of divergent, if not contrary, decisions on the same issues in different jurisdictions is apparent. The majority rule, that corporate officers owe no duty to individual stockholders in purchasing their stock, would be virtually nullified. Other rules governing the internal affairs and management of corporations would be thrown into a state of confusion because corporate officers would be compelled to comply with the rules of every state in which the corporation might conduct business. In many instances compliance with divergent laws would be impossible with the result, *as here*, that the officers could be found guilty of fraud in other jurisdictions for actions which, under the laws of the state of incorporation, were perfectly legal and proper. The jurisprudence of this country, which requires that the internal affairs of foreign corporations be determined by the laws of the state of incorporation, avoids the confusion which will result if the decision below is allowed to stand. That decision should be reversed.

On the other hand, if a "grouping of contacts" theory is to become an exception to the general conflict-of-laws rule that the internal affairs of foreign corporations are to be determined by the laws of the state of incorporation, the matter is of sufficient importance to warrant a pronouncement to that effect by this Court.

From petitioner's standpoint, it is obvious that if there was no breach of fiduciary obligations of its officers,

the sales of respondents' stock could not be rescinded. Implicit in the decision below is a recognition of the fact that if this action had been brought in Delaware, petitioner's home State, the result would have been different and petitioner would have prevailed. The Federal Courts in Delaware would most certainly have applied and followed the laws of Delaware because Delaware would then have been both the state of incorporation and the forum. Since the laws of Delaware, as correctly found by the Court below, impose no fiduciary duty on corporate officers in purchasing the stock of individual stockholders, there was no breach of fiduciary obligations by petitioner's officers. Surely the mere accident of diversity of citizenship and the fact that this action could be brought in Louisiana because of such diversity should not change the result. This is particularly true because the diversity jurisdiction of the Court in this action depends wholly upon the fact that petitioner, the sole defendant, is a corporate citizen existing by virtue of the laws of Delaware. Its internal affairs must be governed by the laws of that State.

Petitioner's stockholders, who were previously incorporated under the laws of Louisiana, deliberately dissolved the Louisiana corporation in 1940 and obtained petitioner's charter in Delaware to obtain the advantages of the Delaware corporation laws. In holding that the laws of Louisiana should govern the internal affairs of petitioner, the Court below overlooked its own prior decision in *Jefferson Lake Sulphur Co. v. United States, 1952 (appealed from E.D.La.) 195 F. 2d 1012, 1015,* wherein it stated:

> "A corporation organized under the laws of the Delaware does not have the same rights and powers as one organized under the laws of New Jersey.*** It follows that the stockholders of the Louisiana corporation would not have formed the New Jersey corporation unless there had been some advantage in the laws of New Jersey over the laws of Louisiana which made the former State a more desirable

one for the corporate domicile of their business. Incorporators who create a new legal entity for their own business reasons must accept the burdens as well as the benefits that necessarily result from legal fiction."

2.

IN HOLDING THAT THE LOUISIANA CONFLICT-OF-LAWS RULE IS SILENT AS TO WHICH LAW DETERMINES THE EXISTENCE AND EXTENT OF FIDUCIARY DUTIES BETWEEN OFFICERS AND STOCKHOLDERS OF A FOREIGN CORPORATION, THE COURT OF APPEALS HAS DECIDED AN IMPORTANT STATE QUESTION IN A WAY IN CONFLICT WITH APPLICABLE STATE LAW.

Under *Erie R. Co. v. Tompkins, 304 U. S. 64*, and *Klaxon Co. v. Stentor Electric Mfg. Co., 313 U. S. 487*, the Courts below in this diversity case were required to refer to the Louisiana conflict-of-laws rule to ascertain which law, that of the forum or the state of incorporation, should determine the existence or non-existence of fiduciary obligations between the officers and stockholders of petitioner, a Delaware corporation. This was recognized by the Court of Appeals in its opinion in the following language:

> "It is well settled that a federal court in a diversity case must apply the conflict-of-laws rule of the State in which it sits. While Louisiana's conflict-of-law is silent on which law determines whether such a fiduciary relationship exists in a foreign corporation, its various conflict-of-laws rules are generally the same as in other States. Therefore, we must look to the general law". (Appendix, p. 132).

The foregoing statements were made by the Court of Appeals in an opinion refusing a rehearing, completely reversing the basis of its prior opinion on the merits and without affording petitioner an opportunity to be heard on the subject. In stating that the Louisiana conflict-of-laws rule is silent, the Court below erroneously de-

cided a question of Louisiana law, in a way which conflicts with applicable decisions of the Louisiana Supreme Court.

In *Succession of Fisher, 1958, 235 La. 263, 103 So. (2d) 276, 281*, the Louisiana Supreme Court said:

> "The First Church of Christ, Scientist, in Boston, Massachusetts, is, among other things, a limited corporate body created by the Massachusetts Legislature, and therefore all of the church's legal rights and powers derived from and must be determined by the law of that State".

In *State v. North America Land & Timber Co., 106 La. 621, 632, 633, 31 So. 172*, the Louisiana Supreme Court said:

> "Courts will not, however, determine matters relating to the internal management of a foreign corporation, arising between one set of shareholders and persons claiming to be the officers as well as shareholders of the corporation. But legal relations between a corporation and its shareholders are to be determined by the law of the home State. Tayl. Priv. Corp. (3d Ed) 292."

In *Jones v. Shreveport Lodge #122, 221 La. 968, 60 So. 2d 889, 891*, the Louisiana Supreme Court said:

> "It is a universally accepted principle of law that a corporation, owing its existence to the will of the sovereign and deriving its powers by grant from that source, can function only in accordance with the law creating it."

See also the decisions of the Louisiana Supreme Court in *Wilkinson v. Wogan, 162 La. 133, 110 So. 176; Barber Asphalt Pav. Co. v. City of New Orleans, 41 La. Ann. 1015, 1018, 6 So. 794; Martel v. Block, 154 La. 863; 867, 868, 98 So. 398;* and also *Wasson v. Gatling, La. App. 184 So. 596; Lake Superior Piling Co. v. Stevens, La. App. 60 So. 2d 221.*

In addition to the foregoing pronouncements on the subject by the Louisiana Supreme Court, this Court in a Louisiana case, *Black v. Zacharie & Co., 3 How. 483, 511,* said:

> "From the nature of the stock of a corporation, which is created by and under the authority of a State, it is necessarily, like every other attribute of the corporation, to be governed by the local law of that State, and not by the local law of any foreign state."

The Court of Appeals for the Fifth Circuit has itself recognized, in prior decisions in Louisiana cases, that the laws of the state of incorporation determine the obligation and powers of the stockholders of a foreign corporation. See its decisions in *Speakman v. Bernstein, 5th Cir. (appealed from W.D. La.) 59 F. 2d 520; Palmer v. Chamberlin, 5th Cir. (appealed from E.D.La.) 191 F. 2d 532, 536;* and *Jefferson Lake Sulphur Co. v. United States, supra, 195 F. 2d at page 1015.*

In this very case, the District Judge, who is from the Louisiana bar, made the following findings in his opinion on the preliminary injunction *(Johnson v. Mansfield Hardwood Lumber Co., 143 F. Supp. 826, 836,* Appendix p. 17):

> "Defendant is a Delaware corporation. As such, it, its stockholders, and persons claiming against it are subject to the corporation laws of that state."(5)

Accordingly, in holding that the Louisiana conflict-of-laws rule is silent as to which law determines the powers and obligations of stockholders of a foreign corporation and in holding that it should apply the laws of the forum (Louisiana) to determine the fiduciary

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(5) This statement by the District Judge, who is from the Louisiana bar, is entitled to "special weight". *Bernhardt v. Polygraphic Co., 350 U.S. 198, 204; MacGregor v. State Mut. Life Assur. Co., 315 U.S. 280; Hillsborough v. Cromwell, 326 U.S. 620, 630; Steele v. General Mills, Inc., 329 U.S. 433, 439.*

obligations between officers and stockholders of a Delaware corporation, the Court of Appeals below has decided a state question in a way in conflict with applicable state law and should be reversed.

3.

IN HOLDING IN THIS DERIVATIVE-TYPE DIVERSITY CASE THAT THE ACTION COULD PROCEED AGAINST THE CORPORATION ALONE; THAT THE COURT HAD THE POWER BY A MANDATORY PRELIMINARY INJUNCTION TO COMPLETE THE LIQUIDATION OF THE CORPORATION, THE SOLE DEFENDANT, AND IRREVOCABLY DIVEST IT OF ITS EVERY REMAINING ASSET; AND THAT THE TRUSTEE IN POSSESSION OF SAID ASSETS, THE STOCKHOLDERS WHOSE TITLE TO SAID ASSETS WAS PUT AT STAKE, AND THE ALLEGED WRONGDOING OFFICERS ARE NOT INDISPENSABLE PARTIES, THE COURT BELOW DECIDED FEDERAL QUESTIONS IN A WAY IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT.

The sales of respondents' stock took place between May 25 and November 14, 1953 (R. 91). On September 26, 1955, petitioner's remaining twenty-four stockholders voted the liquidation of petitioner under a formal plan conforming to 26 U. S. C. 337 (a)(6), liquidators were appointed and the sale of petitioner's assets in liquidation was authorized (R. 94). On June 22, 1956, after petitioner's liquidation had been largely completed, respondents filed this action against petitioner, the corporation, alone, alleging that the sales of their stock were induced by a fraudulent conspiracy of petitioner's officers to liquidate it for their own personal gain, and praying for a rescission of the stock sales, an accounting and a

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(6) As found by the Court below, on August 16, 1954, Sections 331 (a) (1) and 337 (a) of the 1954 Internal Revenue Code became effective abolishing the double capital gains tax in liquidation, that is, on both the corporation and the stockholders (Appendix p. 115).

pro rata share of petitioner's assets distributed in liquidation (R. 1362-1378).

By alleging that the officers acted in their own interest in a manner destructive of the corporation itself and of the rights of respondents and by praying for an accounting and pro rata distribution of petitioner's assets, respondents set forth in their complaint, and particularly Article 28 thereof (R. 1371, 1372), a situation referred to by this Court in *Hawes v. Oakland, 104 U. S. 450,* as a classic example of one requiring the derivative action. However, this is neither a derivative nor a class action[7] and the sole defendant is the corporation. In permitting this action to proceed against petitioner alone, in the absence of the alleged wrongdoing officers, the Court below came in conflict with decisions of this Court in *Swanson v. Traer, 354 U. S. 114, Koster v. Lumbermen's Mut. Cas. Co., 330 U. S. 518, Smith v. Sperling, 354 U. S. 91,* and *Hawes v. Oakland, supra. Cf. Venner v. Great Northern Railroad, 209 U. S. 24.*

Although respondents also prayed for an injunction to prevent any further distribution of petitioner's assets in liquidation, the District Court, prior to trial on the merits, issued a mandatory preliminary injunction completing the liquidation of petitioner and *irrevocably* divesting it of its every remaining asset (approximately $1,300,000.00 in cash, an interest in minerals under approximately 60,000 acres of land, and other real property) which assets were placed in the custody of a Trustee-Bank, as stakeholder, to be held by it until a judicial determination of whether respondents or the stockholders of petitioner were entitled to such assets and in what

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(7) Petitioner purchased 1829 of the 4836 total shares of its outstanding stock. Respondents, the nine stockholders who filed this action as individuals, owned only 1567 shares (R. 90-94). The remaining 262 shares were owned by eight stockholders who did not sue nor join in this action, nor are they represented herein. (R. 90-94).

amounts.(8) This order, although called a mandatory preliminary injunction, specifically provided that the assets "are in no event to revert to the defendant herein" (Appendix p. 38), and was a final decree insofar as petitioner, the only defendant in this case, is concerned—issued before one word of evidence was taken in a trial on the merits.

Petitioner's contention that the injunction, which irrevocably stripped it of its assets prior to a trial on the merits, deprived it of property without due process of law in violation of the Fifth Amendment to the Constitution of the United States was overruled by both the District Court and the Court of Appeals below, although the District Judge expressed serious doubt of his right to issue an injunction in such terms (R. 1542 1543, 1575), and the Court of Appeals stated that, under normal circumstances, the action of the District Court "might well have seemed improvident" (242 F. 2d, at page 47. Appendix p. 47). The holding that petitioner could be irrevocably divested of its assets by a mandatory preliminary injunction conflicts with the decision of this Court in a Louisiana case, *Lacassagne v. Chapuis, 144 U. S. 119*, in which this Court held that the function of an injunction is to afford preventive relief, not to redress alleged wrongs which have been committed already, and said:

> "An injunction will not be used to take property out of the possession of one party and put it into that of another."

Far more than merely transferring property from the *possession* of one party to another, an injunction was

(8) The order, mandatory in form and extraordinary in substance, provided that the assets be held by the Trustee until final determination by the Court of "the persons legally entitled to receive them and in what amounts ***" and further provided that, in the event of its dissolution by any court prior to final judgment, the title to the assets "shall immediately vest in the stockholders of defendant". (Appendix p. 38).

used by the Court below to irrevocably divest the only defendant of *title* to its every remaining asset. This order, issued prior to a hearing on the merits, clearly violated the due process clause of the Federal Constitution.(9) The decision below on this constitutional question is thus in conflict with an applicable decision of this Court.

Petitioner's contention that the Trustee-Bank, as stakeholder in charge of its assets, its remaining stockholders, whose title to the assets was thus put at stake, and its officers charged with fraud were indispensable parties, whose presence would destroy the jurisdiction of the Court, was overruled on the theory that under Delaware law petitioner was the proper defendant, an interpretation by both Courts below accepting the law of Delaware as governing the obligations of petitioner and its officers and stockholders (Appendix p. 17 and 47).

The holding that the Trustee-Bank in possession of the funds and property is not an indispensable party conflicts with *Massachusetts & S. Const. Co. v. Cane Creek Twp., 155 U. S. 283*, in which this Court said:

> "The plea to the jurisdiction should have been sustained. The substantial object of the suit was to obtain possession of the bonds. The Bank was the party in possession, and, although it claimed no interest in the bonds as against the plaintiff and its co-defendants, yet possession could not be enforced in favor of the plaintiff except by a decree against it. Where the object of an action or suit is to recover the possession of real or personal property, the one in possession is a necessary and indispensable (and not a formal) party."

The holding that petitioner's stockholders who may be sued for contribution in subsequent suits and who are the only claimants other than respondents to the funds

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(9) In Louisiana, a court cannot hold title in suspense by the appointment of a trustee because legal and equitable titles are tenures alien to the civil law. *Buck v. Larcade, 183 La. 570, 164 So. 593.*

and property in the hands of the Trustee-Bank, are not indispensable parties conflicts with *Ribon v. The Chicago, Rock Island & Pacific R. Co., 83 U. S. 446*, and with *Lumbermen's Mut. Cas. Co. v. Elbert, 348 U. S. 48*, and *Shields v. Barrow, 17 How. 130*, in which this Court defined "indispensable parties" as "persons who not only have an interest in the controversy, but an interest of such a nature that a final decree cannot be made without either affecting that interest, or leaving the controversy in such a condition that its final determination may be wholly inconsistent with equity and good conscience".

The Court below has treated this litigation as though the corporation, the only defendant, has not been completely liquidated by order of the Court itself and as though its officers and stockholders, whose presence would destroy diversity jurisdiction, are parties to the action. It has based its decision upon a breach of fiduciary obligations of the officers although the alleged fiduciaries are not before the Court. (10) It has impounded the corporation's assets while it adjudicates the conflicting claims thereto of respondents and the corporation's stockholders, although the latter are not before the Court. It has ordered a rescission of the stock sales, which is impossible in view of the complete liquidation of the corporation by order of the Court itself. (11) It has issued

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(10) In *Chalmette Petroleum Corp v. Chalmette Oil Dist. Co., Inc., 5 Cir. 1944, 143 F. 2d 826, 829*, the Court below said:

> "In this case the full board of directors made these leases, not Williams and Batson. But Williams and Batson were themselves directors, and supposedly best informed about the business, and advised the making of them. *** The prayer for account of profits presents no pressing question. *** Williams and Batson, the fiduciaries here involved, are not before the Court and no account is sought from them. Appellee (the corporation) was not a fiduciary."

(11) Restoration of the status quo of petitioner would cause a tax loss of approximately $1,500,000.00 (Appendix p. 37). Following the complete liquidation of petitioner, the transferable character of the stock was destroyed and rescis-

an order for an accounting with which the liquidated corporation, irrevocably stripped of its every asset, obviously cannot comply. The end result, a judgment which, in effect, awards the funds and property in the possession of the Trustee-Bank to respondents to the exclusion of the only possible adverse claimants, petitioner's stockholders who are not before the Court, represents a glaring departure not only from the precedents established by this Court but from established judicial process as well.

4.

THE COURT BELOW SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AND SO DISREGARDED THE RULES OF APPELLATE REVIEW AND THE FUNCTION OF A FEDERAL COURT OF APPEALS AS TO CALL FOR AN EXERCISE OF THIS COURT'S POWER OF SUPERVISION IN THE FOLLOWING RESPECTS

(A) IN HOLDING THAT "IN STRICT LOGIC — AND IF LITERAL COMPLIANCE IS GIVEN TO THOSE DECISIONS (OF THIS COURT AND OF THE COURTS OF APPEALS FOR THE SECOND, THIRD AND DISTRICT OF COLUMBIA CIRCUITS) —THE OPINION IS FAULTY" AND THEN HOLDING THAT "THOSE DECISIONS ARE, HOWEVER, IN OUR OPINION, EITHER INAPPLICABLE OR UNSOUND".

(B) IN DECLINING TO FOLLOW A CONTROLLING DECISION OF THIS COURT AND DECIDING THE CASE IN A CONTRARY MANNER BECAUSE OF ITS VIEWS AS TO WHAT THE LAW OUGHT TO BE.

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sion of respondents' stock sales was rendered impossible. *Fletcher, Cyclopedia of Corporations, Perm. Ed., Vol. 12A, Sec. 5610, p. 222; Zinn v. Ex-Cell-O Corp., 149 P. 2d 177, aff'g. 141 P. 2d 948; Gamble v. Pen Valley Crude Corp., 104 A. 2d 257.* A completely liquidated corporation, though not formally dissolved, is dissolved *de facto. Weir Long Leaf Lbr. Co. v. C. I. R., 5 Cir. 173 F. 2d 549.*

(C) IN RENDERING AN OPINION ON APPLICATION FOR REHEARING WHICH ADMITTEDLY REVERSED THE BASIS OF ITS PRIOR OPINION ON THE MERITS AND RESOLVED THE CASE UPON A DIFFERENT BASIS WITHOUT AFFORDING THE APPLICANT AN OPPORTUNITY TO BE HEARD.

(D) IN FAILING TO APPLY THE LAWS OF THE STATE OF INCORPORATION TO DETERMINE THE VALIDITY OF INTERNAL AFFAIRS OF PETITIONER AND IN FAILING TO APPLY THE LAWS OF THE FORUM TO DETERMINE ITS LIABILITY OR FREEDOM FROM LIABILITY IN THIS FRAUD ACTION WHEN PROPER APPLICATION OF EITHER SET OF LAWS WOULD RESULT IN A JUDGMENT FAVORABLE TO PETITIONER.

In its opinion, the Court below raised the conflict-of-laws question as to which law to apply — that of Delaware, the state of incorporation, or of Louisiana, the forum, and, in resolving this question, stated that "we must look to the general law". (Appendix p. 133). It then found that the general law, as set forth by the decision of this Court in *Rogers v. Guaranty Trust Co., supra*, and by decisions of the Courts of Appeals for the Second, Third and District of Columbia Circuits, all listed in footnote 6 of its opinion, required the Court to refer to the laws of the state of incorporation. Nevertheless, by applying a "grouping of contacts" theory as an exception to the usual conflict-of-laws rule applicable to corporations, unsupported by any authority and apparently of its own creation, it reached the opposite result and applied the laws of the forum, conceding that in strict logic and if literal compliance is given to "those decisions", its opinion "is faulty". In an effort to explain its conclusion, the Court below stated that "those decisions are, however, in our opinion, either inapplicable or unsound***". The applicability of the decisions referred to is apparent from the Court's own recognition that they correctly state

the general law and that compliance therewith would render its opinion faulty. By citing the decisions as applicable to the question involved and then declaring that they are "either inapplicable or unsound", the inescapable conclusion is that the decision of this Court in *Rogers v. Guaranty Trust Co.* and the decisions of the other Courts of Appeals have been labeled "unsound". The opinion sets forth two possible alternatives — either it is admittedly faulty or else it is based upon loose logic and non-compliance with the applicable law as set forth by this Court. Under either alternative, the Court below disregarded the rules of appellate review and the function of a Federal Court of Appeals. It is not the province of a Federal Court of Appeals to declare decisions of this Court unsound.

In *Kohler v. McClellan, 5th Cir. 1946, 156 F. (2d) 908, 914*, and *Addison v. Commercial Nat. Bank in Shreveport, 5th Cir. 1948, 165 F. (2d) 937, 939*, the Court below recognized the fact that it is without authority to overrule decisions of this Court. In the latter case the Court said:

> "But judges, as we are, of a court the Constitution calls "inferior", we may not turn thus lightly from the way of stare decisis. We must, though blown about by every wind of changing dichotomy, find, if we can, and if we can, follow the path the Supreme Court has taken, though the way be dark and tortuous, its destination uncertain and obscure.
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> • • • •
>
> "For however much we may think it plain that a wrong decision should be down-rightly overruled, "inferior" as we are, we have no function to advise our betters, as the great and wise of old have done, that stare decisis "is not a universal, inexorable" command", that its "rigid dogma of infallibility allows of this much relaxation in favor of truth unwittingly forsaken".

The Court of Appeals below has labored hard to find reasons for refusing to follow the laws of Delaware insofar as those laws apply to the internal affairs and management of a corporation organized under the laws of that State. The reason for its efforts seems to lie in the statements by the Court below that the laws of Delaware are "harsh" and "inequitable" because they impose no fiduciary obligation on officers in purchasing the stock of individual shareholders. Application of the Louisiana law to this case apparently flowed from the Court's effort to apply what it considered to be the "better rule"(12). In doing so, the Court below disregarded the proper function of a Federal Court of Appeals.

In *Klaxon Co. v. Stentor Electric Mfg. Co., supra, 313 U. S. at pages 496, 497*, this Court said:

> "Application of the New York statute apparently followed from the Court's independent determination of the 'better rule' without regard to Delaware law, for no Delaware decision was cited or discussed.
>
> We are of the opinion that the prohibition declared in Erie R. Co. v. Tompkins, 304 U. S. 64, 82 L. Ed. 1188, 58 S. Ct. 817, 114 A.L.R. 1487, against such independent determinations by the federal courts extends to the field of conflict of laws. The proper function of the Delaware Federal Court is to ascertain what the State law is, not what it ought to be".

A review of the progress of this case through the Courts below, as set forth briefly in the statement, *supra*, reveals a departure from the usual course of judicial proceedings. The complete liquidation of the sole defendant and *irrevocable* divestiture if its assets by a mandatory preliminary injunction which was made final; the

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(12) See footnote 4 of the Court's opinion quoting with approval *Fletcher, Cyc. Corps., Sec. 848*, to the effect that the minority view "is the better rule, although not sustained by the weight of authority". (Appendix, p. 119).

rendition of an intemperate opinion on the merits by the District Judge in which he found petitioner's officers guilty of "grasping greed" and "moral bankruptcy", and characterized their actions as "dastardly"; which he later admitted was erroneous in important respects but refused to correct; the complete rejection of these factual findings of actual fraud by the Court of Appeals in its opinion on the merits, in which it found that the District Judge was "clearly erroneous"; the rendition by the Court of Appeals of an opinion finding liability upon the basis of constructive fraud, constructive trust and equitable lien which it later recognized was impossible in Louisiana, being alien to the Louisiana civil law; the rendition of a per curiam opinion by the Court of Appeals in which it refused a rehearing, but, without affording petitioner an opportunity to be heard thereon, admitted that its prior opinion was incorrect and thereafter based its decision in the case upon an entirely new theory—that the breach of a fiduciary duty by petitioner's officers, which admittedly does not exist under the laws of Delaware, is called "fraud" in Louisiana; and the rendition of a judgment rescinding the sale of respondents' stock and ordering an accounting, although rescission, restoration of the status quo, and an accounting are impossible because petitioner has been completely liquidated by order of the Court itself, are all considered such departures from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

The requirements in Louisiana for rescission of a contract of sale on the grounds of fraud are specifically set forth in Article 1847 of the Louisiana Civil Code. Paragraph 7 of that article provides, in language that is clear and free from ambiguity, that "design" or intent is required. The Louisiana Supreme Court, in numerous decisions interpreting this codal provision, has unequivoc-

ably stated that intent is an essential element of fraud[13]. It has further declared that the charge of fraud is a most serious one which must be proven "to that degree of certainty which warrants the conviction of a person who is charged with the commission of a crime, i.e., beyond a reasonable doubt[14]", and that in Louisiana fraud is never presumed[15].

The Court of Appeals recognized the Louisiana law on the subject and made the following statement in its opinion refusing a rehearing:

> "***'constructive fraud', found in the law of fiduciaries and characterized by the lack of the 'intent to defraud', is *impossible* under Article 1847". (Appendix, p. 137, emphasis supplied)

However, despite that statement, it appears that the Court below, after declaring that it would attempt to clarify and *correct* its prior opinion based on the doctrine of constructive fraud, thereupon embarked upon an attempt to justify its prior application of that doctrine to this Louisiana case. An analysis of Louisiana decisions (largely court of appeals cases) admittedly lead to "results which seem to common-law lawyers hard to obtain under a literal interpretation of the Civil Code". (Appendix, p. 143). Nevertheless, the Court of Appeals found that petitioner is liable for the breach of its officers'

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(13) *Buxton v. McKendrick, 223 La. 62, 64 So. 2d 844; Garnier v. Aetna Insurance Co. 181 La. 426, 159 So. 705,* and *Sanders v. Sanders, 222 La. 233, 62 So. 2d 284,* setting forth other decisions of the Louisiana Supreme Court to the same effect

(14) *Belcher v. Booth, 164 La. 514, 114 So. 116; Sanders v. Sanders, supra, footnote 13; LaCroix v. Recknagel, 230 La. 842, 89 So. 2d 363; Buxton v. McKendrick, supra, footnote 13, and Angichiodo v. Cerami (W.D. La) 35 F. Supp. 359, 369.*

(15) *Sanders v. Sanders, supra, footnote 13, and American Guaranty Co. v. Sunset Realty & Planting Co., 208 La. 772, 23 So. 2d 409, 430.*

fiduciary duties which "is called fraud" (Appendix, p. 141).

It will be noted that in its first opinion on the merits, the Court of Appeals found, "*after carefully studying all of the evidence in this cause*", that the District Court was "clearly erroneous" in finding that petitioner was liable for "fraud per se" of its officers because the necessary "mens rea" or "intent" element had not been adequately established. (Appendix, p. 118). It will also be noted that the Court below in its second opinion on the merits, refusing a rehearing, did not reinstate the District Court's factual findings of actual fraud nor did it set forth any facts upon which a judgment on the grounds of actual fraud could be based. It merely reached the conclusion that liability is predicated solely upon the breach of a fiduciary relationship between petitioner's officers and respondents—which is nothing more nor less than the application of the doctrine of constructive fraud[16].

In *In re Boyce*, 151 F. (2d) 690, 691, the Court of Appeals for the Third Circuit said:

> "No better illustration could be found of the dangers involved in the slippery use of language. Constructive fraud, of course, is not fraud at all as both lawyers and laymen know and understand the term, but conduct which the courts regard as liability

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(16) The doctrine of constructive fraud at common law is explained in *Epstein v. U. S.* 174 F. (2d) 754, 765 and in *Hornaday v. First Nat. Bank of Birmingham*, 65 So. 2d 678, 687 (Cf. footnote 11, Appendix, p. 138). That doctrine is a creature of equity jurisprudence of some of the common law states whereby fraud is *presumed* from the mere fiduciary relationship of the parties to a transaction. It is distinguished from actual fraud in that no *intent* to deceive or defraud is required. Louisiana does not have the "common law" and "equity" systems established in other states. *LeBlanc v. City of New Orleans*, 138 La. 243, 70 So. 212; *Osborn v. City of Shreveport*, 143 La. 932, 938, 74 So. 542; *Elbert v. Lumbermen's Mut. Cas. Co.* 5th Cir. 202 F. (2d) 744, 746; and *Pomeroy's Equity Jurisprudence*, 5th Ed. Vol. 1, pages 766-773.

creating and which, therefore, has some of the consequences which actual fraud has."

There are actually two conflict-of-laws principles involved in this case. Under the general law (1) the internal affairs of a foreign corporation are determined by the laws of the state of incorporation and (2) the liability or freedom from liability of a defendant in a fraud action is determined by the laws of the forum. With reference to the first principle, the Court of Appeals below correctly found that the laws of Delaware, the state of incorporation, imposed no fiduciary duty to disclose on petitioner's officers in purchasing respondents' stock. With reference to the second principle, it correctly found that constructive fraud is *impossible* in Louisiana because "intent" is an essential element under the provisions of the Louisiana Civil Code. As we have shown, proper application in this case of the laws of either state would result in a judgment favorable to petitioner. However, the Court of Appeals, in an effort to decide the case upon what it considers to be "the better rule", applied neither. In doing so, it had to declare applicable decisions of this Court and other Courts of Appeals "unsound", reached results which it admitted were hard to obtain, and apparently accomplished the impossible. There is a compelling need for this Court to speak firmly on the confines of appellate review which have been so clearly exceeded by the Court below.

CONCLUSION

The practical effect of the decision below, in resolving both conflict-of-laws and jurisdictional questions contrary to previously well-established precedents, is to permit this type of litigation to be brought in the federal courts, solely on the basis of diversity of citizenship, against the corporation alone and, at the same time, to permit the validity of the internal affairs of the corporation to be determined by the laws of any forum in which the action might be brought. The result is that corporate activities, legal and proper under the laws of the corporation's home state, might be declared to constitute fraud under the laws of the forum. Previously, such litigation has been asserted as a derivative action *on behalf of* the corporation, joinder of the alleged wrongdoing officers as indispensable parties has been required, and the validity of internal affairs of the foreign corporation has been determined by the laws of the state of incorporation. It is of paramount importance to every corporation in this country that the conflict arising from the decision below be resolved by this Court. Moreover, this Court should speak firmly on the lack of power of the court below to declare applicable decisions of this Court and other Courts of Appeal "unsound" and should insure that disregard of the proper scope of appellate review is corrected.

The court below has rendered a decision which conflicts with decisions on the same matter by other Courts of Appeals and this Court; it has decided an important state conflict-of-laws question in a way in conflict with applicable state laws; it has decided federal jurisdictional and constitutional questions in a way in conflict with applicable decisions of this Court; and it has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

For the foregoing reasons, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

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IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

* * * * * * * * * * * * * * * * *

CIVIL ACTION

No. 5562

HATTIE A. JOHNSON, ET AL.

vs.

MANSFIELD HARDWOOD LUMBER COMPANY

* * * * * * * * * * * * * * * * *

BEN C. DAWKINS, JR., CHIEF JUDGE.

OPINION ON PENDING MOTIONS AND APPLICATION FOR PRELIMINARY INJUNCTION

A program of corporate purchase of minority stock, as treasury shares, has reaped a whirlwind of bitterness, resulting in this three-pronged action.

Brought here under the Diversity Statute(1) by eight plaintiffs, and addressed to our equitable powers, the suit is for a preliminary injunction, for rescission of certain stock sales made by plaintiffs to defendant in 1953, and for an accounting.

In their verified complaint, supported by various documents, plaintiffs pitch their claims on charges of deliberate fraud, or, alternatively, upon constructive fraud and unjust enrichment. They allege that, in 1953, defendant, Mansfield Hardwood Lumber Company (sometimes called "Mansfield"), through its President, A. S. Johnson, and its Vice-President, Brown McCullough, fraudulently conceived a scheme through which it induced them to sell their stock in the company to it, on the pretense

(1) 28 U.S.C.A. § 1332. Plaintiffs are resident citizens of Arkansas and Louisiana. Defendant is a corporate citizen of Delaware, with its principal office and place of business in Shreveport, Louisiana. Substantially more than $3,000 is in controversy.

that no dividends would be paid for the next fifteen to twenty years, that all profits would be reinvested in a reforestation program on its extensive land holdings; and that the corporate assets would not be liquidated and distributed to its shareholders in the foreseeable future.

At that time Mansfield's outstanding capital stock consisted of 4836 shares, of which plaintiffs owned 1516 shares, or approximately 33 per cent. It is alleged that the corporate management, together with others dominated by them, owned 2751 shares, or approximately 56 per cent of the total, giving that group full control of its affairs.

Plaintiffs aver that all of them, except Mrs. Hattie Johnson and Mrs. Jeanette Johnson Jennette, sold their stock to the company for $350 per share, and the latter two, owning 547 and 668 shares, respectively, sold theirs for $400 per share. All plaintiffs contend that in doing so they accepted as true, and relied upon, the representations made to them by Man field's officers that no dividends would be paid for many years, and that no liquidation and distribution of the company's assets would be made. Since its stock was closely held, mostly by members of the same two families, was not traded on the open market and, accordingly, had no established market value, they also relied, they say, on the officers' statements as to the intrinsic value of the stock, for which they first were offered $300 per share.

Plaintiffs further say that, in arriving at their estimates of stock value, they placed strong reliance upon defendant's annual Balance Sheets, prepared and distributed to stockholders by the management. Copies of two of these statements are attached to the complaint. Under the heading of "Assets", as of June 30, 1952, one of the larger items was "Timber and Timber Lands", then valued at $969,234.03. The Balance Sheet of June 30, 1953, gave these assets a value of $987,674.84. Actually,

but allegedly unknown to them at the time, the true value was almost $9,000,000.

Thus deceived, they turned in their stock for the prices mentioned, and were paid by the company with corporate funds, the last sales having been consummated by Mrs. Johnson and Mrs. Jennette on November 14, 1953.

Plaintiffs next aver that, notwithstanding such representations by Mansfield's officers, both as to stock values and the lack of prospects for liquidation, they began negotiations for sale of the corporate assets within a few months after the stock had been bought. On September 26, 1955, defendant's then officers, directors, and remaining stockholders voted to liquidate completely, selling all, or substantially all, of the assets. To that end, on May 25, 1956, it sold all of its timbered lands, comprising about 93,000 acres, to Robert Gair Company, Inc., for $8,823,000, $5,000,000 being paid in cash, and the balance represented by a mortgage note for $3,823,000 bearing 3 per cent per annum interest, payable in five years. All minerals underlying these lands were reserved to defendant, to be distributed pro rata to its remaining stockholders. A lumber mill owned by defendant, at Winnfield, Louisiana, was sold for $285,000, on September 29, 1955, and another mill at Zwolle, Louisiana, was sold on May 25, 1956, for $75,000. Another asset, the Reader Railroad in Arkansas, was sold for an unascertained amount. No one apparently knows the exact total worth of the minerals reserved for distribution.

Plaintiffs calculate that defendant's assets will realize, or be worth, approximately $10,000,000, from which each share of the remaining stock will receive about $3,000, as contrasted to the $350 and $400 per share they received. If they had not sold their shares, in reliance on defendant's representations, they now would be entitled to receive more than $2,000 per share. Thus, they say, de-

fendant obtained stock worth approximately $3,300,000 for $609,200, or about 18 per cent of the true value.

As stated, plaintiffs claim that all this resulted, to their serious detriment, from a fraudulent scheme on the part of defendant's officers, Johnson and McCullough. In the alternative, in the event it is determined that no deliberate fraud was practiced, plaintiffs contend that in their sale and defendant's acquisition of the stock they and defendant neither understood the true value of the rights being sold and acquired, and because of this mutual error of fact the sales were invalid.

In the future alternative, plaintiffs contend that in acquiring their stock defendant used cash and credit which equitably belonged to them and that, accordingly, no consideration was paid for the stock, or such consideration as was paid was not serious, and the sales were invalid.

In the still further alternative, plaintiffs urge that the price paid by defendant was so utterly out of proportion to the true value of the stock as to render the consideration vile, and to permit those who stood in a fiduciary relationship to plaintiffs to enrich themselves unjustly at plaintiffs' expense, and, therefore, that the sales were invalid.

Plaintiffs pray for a decree rescinding the sales of their stock to defendant, recognizing them as its equitable owners, requiring defendant to account to them for their share of the liquidation proceeds, and to deliver to them their proper part of the mineral rights reserved for distribution. They further allege that defendant is about to distribute a large amount of cash on hand, and to be received, to the remaining shareholders, and proposes to transfer to them title to undivided interests in the minerals, which would make it possible for third persons to acquire indefeasible interests therein, all to plaintiffs' irreparable injury. Accordingly, they have asked for, and were grant-

ed, a temporary restraining order, renewed each ten days since the suit was filed on June 22, 1956, to hold matters *in status quo* until determination of the suit on its merits. They further pray for a preliminary injunction for the same purpose.

Defendant has filed a motion to dismiss, encompassing several points of defense, and a verified answer, with supporting documents, which vigorously denies the alleged fraud and asserts additionally a number of affirmative defenses. While admitting generally that plaintiffs are former stockholders, who sold their stock to it for the amounts mentioned, partly at the behest of Johnson and McCullough, defendant contends that all statements made by them, in the negotiations leading up to the sales, were completely honest and factually correct. It further contends, with particular respect to the stock purchased from Mrs. Johnson and Mrs. Jennette, that they were thoroughly familiar with the company's affairs; that they initiated the negotiations and in effect importuned defendant to buy their stock, which constituted about 80 per cent of the total purchased, being all but 281 shares out of 1516 which were bought; that defendant did not have sufficient cash or liquid assets on hand to pay the entire purchase price ($494,000); hence, it paid them $121,500 cash, giving its notes for the balance, due serially each six months, secured by a mortgage on 11,845 acres of its property; that it paid the notes as they matured, and on May 25, 1956, it called the remainder of the unpaid notes, as was its privilege under the mortgage, paying the full balance of principal and interest, plus a 2 per cent charge for the privilege of calling the notes prior to their maturities. Defendant also alleges that, in addition to the payments already mentioned, it caused to be paid to Mrs. Johnson and Mrs. Jennette a sum equal to a 2 per cent dividend upon their stock, which payment was made some time subsequent to the consummation of the stock sale. Accordingly, defendant contends that by their actions they

have ratified, confirmed and made valid their sale of stock to it, and now are estopped to bring this action to rescind it.

It further contends that it did not "immediately" begin to look for a sale of its timbered lands, after it had purchased plaintiffs' stock, but admits that in about the month of April, 1954, it began to negotiate with International Paper Company for that purpose. It further admits that on September 29, 1955, it agreed to sell those lands to the Gair Company, reserving all mineral rights, for $8,823,000.

While admitting that it was a closely held corporation, it denies that there was no market price for its stock; and it denies that plaintiffs had no accurate knowledge of the value of the company's assets, but, on the other hand, affirmatively alleges that they had representatives on the Board, as well as having participated in stockholders' meetings, and that they were entirely familiar with the company's assets.

It admits that the company followed the custom of circulating annual financial statements among its stockholders, but affirmatively alleges that these were accurate and correct according to the company's books. It denies that the statements made in the Balance Sheets of June 30, 1952 and 1953, were in any sense incorrect or that plaintiffs were required to evaluate their shares solely upon such statements. It affirmatively avers that the company's books, from which the statements were taken, were the usual and customary books in such a business, and that, in evaluating their shares plaintiffs considered the nature and value of the assets rather than the book values alone.

Defendant further urges that the corporate liquidation now has been largely completed and that plaintiffs are without right to enjoin its further liquidation. If defendant is enjoined, it avers that a tax consequence,

amounting to a $1,500,000 loss, will occur, due to defendant's inability to complete the plan of liquidation previously submitted to, and approved by, the United States Department of Internal Revenue, within one year from September 26, 1955. It further urges that should the injunction issue damages of approximately $150,000 per year it will accrue because of nondistribution to the remaining stockholders of amounts realized from the liquidation.

Defendant next alleges that, if plaintiffs are entitled to any relief, which is denied, they have an adequate remedy at law. It avers that all plaintiffs had full knowledge as early as July of 1955, and prior thereto, of the company's proposed plan of liquidation; that defendant's position has changed substantially since it purchased plaintiffs' stock and since July of 1955; that plaintiffs, therefore, are barred by their own laches and are without equity in failing to exercise promptly their alleged equitable right to rescission and an accounting. Accordingly, defendant prays that plaintiffs' demands be rejected at their cost. They also argue that, on consideration of all the pleadings and attached documents, plaintiffs have not shown themselves to be entitled to equitable relief. Hence, their application for a preliminary injunction should be denied.

The motion to dismiss, which must be considered first, makes these points:

1. The complaint fails to state a claim upon which relief can be granted.

2. This is an action for rescission of a sale in which there is no allegation of tender by plaintiffs to defendant of the consideration received by plaintiffs from defendant pursuant to the sale.

3. If plaintiffs are entitled to any relief, which is denied, they have an adequate remedy at law.

4. The complaint affirmatively shows that defendant's position has so changed since the sale that it would be impossible for it to comply with an order granting the relief sought.

5. The complaint affirmatively shows that, if plaintiffs are otherwise entitled to relief, which is denied, they are barred by their own laches.

6. The complaint affirmatively shows that the alleged fraudulent scheme, and the alleged misrepresentations made pursuant thereto, were entered into by and were made on behalf of McCullough and Johnson, as stockholders, and other un-named stockholders, and not on behalf of the corporation.

7. That there is a non-joinder of indispensable parties defendant, namely, the remaining twenty-four shareholders, whose interests will be directly affected by any decree rendered herein.

8. That there is a mis-joinder of parties plaintiff, whose claims do not arise out of the same transaction, occurrence, or series of transactions or occurrences.

These points will be considered seriatim.

1. Defendant's general motion to dismiss for failure to state a claim upon which relief can be granted naturally admits all well pleaded facts in the complaint. If plaintiffs' allegations are true, they clearly would be entitled to the relief they seek. No citation of authority is required to demonstrate that this part of defendant's motion must be, and is, DENIED.

2. In support of its position that plaintiffs must have made, and must allege, a tender to defendant of the amounts paid by it for plaintiffs' stock, as a prerequisite to this action, defendant relies on a decision by a former member of this Court, now retired, *Hollinquest v. Kansas City Southern Railway Co.*, (1950) 88 Fed. Supp. 905,

wherein one of present plaintiffs' counsel was the attorney for the defendant.

There, a personal injury damage suit, it was alleged that an agent of the defendant paid the injured person $100, and obtained a release, shortly after the accident, while she was in such physical and mental condition that she could not appreciate what she was doing, and when she had no opportunity to know or understand the extent of her injuries. Defendant pleaded lack of tender, and the Court ruled as follows:

> "Defendant urges the well settled jurisprudence of this state that, as a condition precedent to an action to annul a contract on the ground of fraud, error or mistake, the complainant must allege an offer to return what was received thereunder and the refusal of defendant to accept it. Byrne v. Hibernia National Bank, 31 La. Ann. 81; Ackerman v. McShane, 43 La. Ann. 507, 9 So. 483; Johnson v. Shreveport Waterworks Co., 109 La. 268, 33 So. 309. In this case the plaintiff does not allege even an informal tender, but charges: 'The defendant has contended and does now contend that the instrument purporting to relieve it of all liability to plaintiff Bessie Hollinquest is valid and binding. Therefore, it would be futile for said plaintiff to make a formal tender of the One Hundred Dollars ($100.00) received at the time of the confection of the said instrument, since an acceptance by defendant of this tender would serve to automatically invalidate the instrument.'
>
> "It is not believed that this is sufficient. The authorities cited by plaintiffs are largely those from other states, whereas here we are bound by the law of Louisiana. See La. Code of Practice, Art. 407, and La. Revised Civil Code of 1870, Arts. 2167-2169; MacLeod v. Hoover, 159 La. 244, 105 So. 305; Harrison v. First National Life Insurance Co., La. App., 179 So. 123; Certified-Roofing Co. v. Jeffrion et al., La. App., 22 So. 2d 143, and cases cited therein. The effect is to bar the action of the wife, until an offer to return the $100 has been made.

> This does not necessarily require the dismissal of the complaint, as tender could be made even during the trial, but since the issue has been raised, it should be done before that event. It will, therefore, be necessary for the plaintiff to make the offer and to amend or otherwise place of record defendant's acceptance or refusal. The question of the alleged nullity on the ground of fraud is one of equitable jurisdiction and will have to be heard and decided by the court, before the action at law for damages to the wife can be heard, either by the court or a jury."

We note that in the latest decision cited, *Certified Roofing Co. v. Jeffrion, et al.*, (La. App., May 14, 1945) 22 So. 2d 143. that Court excused that plaintiff from making tender because it would have been refused by the defendant, stating:

> "It is conceded that there was no formal, legal tender of the return of the money which had been paid but on the other hand it is proven by the testimony of Dejoie, himself, that Mr. Midlo offered to return it and urged him to come to his office to get it, and that he refused to accept it and insisted that he had made a complete and binding compromise. Dejoie also says that he fortified himself in his position by securing the advice of an attorney who advised him to retain the note and not to accept the return of the money. Under such circumstances there was no necessity that the futile ceremony of making a formal tender be resorted to. See McStea & Value, v. Warren & Crawford, 26 La. Ann. 453; Alter v. Shepherd et al., 27 La. Ann. 207; Zimmerman v. Langles, 36 La. Ann. 65; Frey v. Fitzpatrick-Cromwell Co., 108 La. 125, 32 So. 437; Central Hdwe. Co., Inc., v. Elliott, 3 La. App. 572."

For their part, plaintiffs here rely on a decision by the Louisiana Supreme Court, *American Guaranty Company v. Sunset Realty & Planting Company*, 208 La. 722, 23 So. 2d 409, rendered on rehearing (*loc. cit.* 23 So.

2d 430), on May 2, 1945, in an action to rescind certain deeds on grounds of fraud, where the Court ruled:

"Was plaintiff required by law to tender or return the purchase price received before instituting annullment proceedings? It appears that the plaintiff did not tender or return the price received from Small for the lands and there has been production on Lot 74 by the Texas Company requiring an accounting, in the event the plaintiff is successful in this suit and the petitory actions. The Texas Company, in this case has also prayed, in the event the quitclaim deeds are set aside, that it be reimbursed the amount of the expenses incurred in drilling the well on the land covered by the second quitclaim deed, citing Martel et al. v. Hunt et al., 195 La. 701, 197 So. 402.

"In State v. Hackley, Hume & Joyce, 124 La. 854, 50 So. 772, 774, where the plaintiff sued to rescind the sale of lands on the ground of fraud but failed to tender or return the purchase price and the defendant pleaded a lack of tender, the court, on rehearing, said:

"'The exception of want of tender was properly overruled. *Previous tender is not required in a suit to set aside a sale on the ground of fraud.* Germaine v. Mallerich, 31 La. Ann. 371; Heirs of Burney v. Ludelling, 41 La. Ann. 627, 6 So. 248; Killelea v. Barrett, 37 La. Ann. 865; Self v. Taylor, 33 La. 769; Heirs of Wood v. Nicholls, 33 La. Ann. 744; Aronstein v. Irvine, 48 La. Ann. 301, 19 So. 131, *Especially where an accounting is alleged to be due.* 28 Ency. Pl. & Pr. 834.'

"In the case of Consolidated-Progressive Oil Corp. v. Standard Oil Co. of Louisiana, 158 La. 982, 105 So. 36, 38, an action was filed to set aside an assignment of a mineral lease for alleged fraud. There had been production on the property which would require an accounting, if the plaintiff prevailed. The defendant under its exception of no cause of action alleged that the plaintiff had failed to tender or return the price received as consideration. In disposing of this issue, the Court stated:

"The defendant, the Palmer Trust, urges under the exception of no cause of action that, as plaintiffs have failed to allege payment or tender of the price received, as a condition precedent to the maintenance of their action for the rescission of the assignment and the recovery of the oil produced, the petition in this case fails to set forth a cause of action.

"This contention is not sound, as previous tender is not required in a suit to set aside a sale on the ground of fraud, as in the present case. [Citing the above referred to authority.]' (Brackets ours.)" (Emphasis supplied.)

The decision just quoted from appears to be the last word on this subject by the highest Louisiana Court, notwithstanding earlier jurisprudence apparently to the contrary. As applied here, therefore, these plaintiffs are not required to tender back to defendant the amounts they received for their stock, especially since they pray for an accounting which, if granted, would entitle them to recover more than five times the price they were paid, less the amounts they received. Moreover, in keeping with the judicial philosophy enunciated in *Certified Roofing, supra*, we feel that plaintiffs should not be required to make a tender to defendant, because we know it would be refused — a vain and useless thing.

Accordingly, this part of defendant's motion must be, and is, DENIED.

3. Do plaintiffs have an adequate remedy at law? We think not.

If plaintiffs were to be relegated to an action in damages, they would find themselves, should they prevail, with a judgment against an empty shell—a corporation which had transferred all of its assets to its remaining share holders, in keeping with its plan, of liquidation and distribution, on or before September 26, 1956. Then, but only

then,[2] could plaintiffs bring action against the individual stockholders who profited from the liquidation at plaintiffs' expense. As many as twenty-four separate suits, against each stockholder for his virile part, could or would be required. Each such defendant could, and undoubtedly would, insist upon being sued at his domicile. We are informed that some of them live outside Louisiana, as far away as New York City and Mineral Springs, Texas.

Moreover, if defendant transfers to the remaining stockholders pro rata the mineral interests it reserved in the sale of its timbered lands to Robert Gair Company, Inc., these stockholders in turn easily could put those interests partly or wholly beyond plaintiffs' reach by executing leases, and mineral or royalty sales to third persons. Likewise, by donations or otherwise, they could so divest themselves of any cash received from defendant, or confuse it with funds of third persons, so as to make it virtually impossible for plaintiffs to enforce any judgments they might obtain.

We are forced to conclude, therefore, that plaintiffs do not have an adequate legal remedy available to them in these circumstances.[3] Hence, this part of defendant's motion must be, and is, DENIED.

(2) **Christian v. Texas Gas & Power Corp.**, (N.D. Tex. 1952) 11 F. R. D. 80, quoted from at some length in Paragraph 7 of these Rulings.

(3) 28 Am. Jur. — Jurisprudence, Sec. 39, p. 236:

"* * * It is not enough that there is a remedy at law. But the remedy, to preclude injunctions, must be certain and reasonably prompt, and as practicable and efficient to the ends of justice and its administration, both in respect of the final relief and the mode of obtaining it, as an injunction would be. The chief cause of the inadequacy of the remedies at law lies in the fact that the injury is irreparable or will occasion a multiplicity of suits."

Sec. 48, pp. 244-245:

"An injury will be regarded as irreparable so as to warrant injunctive relief where it tends toward the destruction of the complainant's estate, or where it is of such a character as to work the destruction of the property as it has been held

4. Defendant's strange argument, that its position has so changed since it bought plaintiffs' stock that it could not comply with an order granting the relief sought, falls of its own weight. It refers, of course, to its having already distributed, before this suit was filed, to its present shareholders the cash it had received in selling its lands, its mills and its railroad. No authorities are cited, none could be, in support of this point.

Factually; the record indicates that defendant probably could respond in full. Irrespective of that, however,

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(3)—CONTINUED

and enjoyed, so that no judgment at law can restore it to him in that character. Very often an injury is irreparable where * * *

"* * * the damages occasioned are estimable only by conjecture and not by an accurate standard." (Such as the value of the extensive mineral interests here involved.)

Sec. 49, pp. 245-246:

"Equity assumes jurisdiction to award relief by injunction where the injury complained of is otherwise irreparable and the remedy at law inadequate. This want of a sufficient legal remedy and the resulting irremedial character of the injury proceed largely from the fact that he will be subjected to a great number of suits at law. Prevention of such multiplicity, always a sufficient ground of equity jurisdiction, furnishes a well-recognized basis for the assumption and exercise of the power to restrain acts injurious to property and civil rights, and to prevent a person from being subjected to the costs and vexation of innumerable suits at law. It is of itself, and without reference to other considerations, sufficient to uphold the remedy."

43 C. J. S. — Injunctions, Sec. 24, p. 449:

"Where the consummation of a wrongful act will injure complainant, and in order to obtain redress at law he would be required to bring many actions against many persons, he is entitled to an injunction to prevent the performance of the act, where the rights of all depend on the same questions both of law and fact

"Also where the consummation of a wrongful or illegal act will probably result in many disputed claims and many actions at law against complainant, his remedy at law is inadequate and he is entitled to the protection of equity by injunction."

it is a sufficient answer, we think, to state that plaintiffs clearly are entitled to seek recovery, to the limit of defendant's ability to respond, from such cash and other assets as it may have on hand when, and if, plaintiffs prevail on the merits of their case.

For these reasons, this part of defendant's motion must be, and is, DENIED.

5. With respect to defendant's plea of laches, it is pertinent to view the practical aspects of the position in which plaintiffs allegedly found themselves. If they discovered, in July of 1955, that defendant had determined to liquidate and distribute, still — according to the essential thrust of their case — they did not know then the true values of defendant's properties, and how much the remaining shareholders would derive from them.

While they then may have been deeply disappointed to learn that — contrary to what they had been told in 1953 — defendant indeed would be liquidated, yet they did not realize then that they had been bilked into taking less than one-fifth of the actual value of their stock.

Their complete disillusionment came on, or shortly after, May 25, 1956 — less than one month before this suit was filed on June 22, 1956 — when they learned that the liquidation actually was returning nearly $10,000,000. Surely, if such circumstances truly were theirs they are not guilty of laches, or any unreasonable delay in crossing swords with defendant.

At this time, we cannot tell with certainty, on the present record, whether plaintiffs actually were so totally ignorant of developments or actual values, as they allege. Because of this, we have concluded that this part of the motion must be, and is, DENIED; but its counterpart in defendant's answer together with all other defenses is to be preserved for determination with the merits of

the case after we have heard the evidence on both sides of the controversy.

6. In so far as defendant's motion attempts to exculpate the company from the alleged conduct of Johnson and McCullough, on the ground that they acted only for themselves and not for the corporation, we must look once again to the complaint, the allegations of which must be accepted as true for the purposes of this motion.

There it is expressly averred that these officers, in confecting and accomplishing their alleged scheme to defraud, were acting in their official capacities as President and Vice-President, respectively. Their knowledge and their action thereby became that of the corporation:

> "* * * if a corporation (which ordinarily does not deal in its own stock) for its own lawful purposes sets out to buy shares through its managing officers, and they by intentional misrepresentation and concealment deceive a selling stockholder who is ignorant of the truth, though he be an inactive director who ought to know, so that he is damaged, we see no reason why the corporation is not bound for the consequences. The deceit practiced by the corporation's high officers in the corporation's business and for its benefit must be taken to be a corporate act, and not ultra vires. 19 C. J. S., Corporations, § 1278(a)(b); 13 Am. Jur., Corporations, § 1125. * * *" *Kohler et al. v. Jacobs et al.*, (5th Cir., 1943) 138 F. 2d 440.

Moreover, the corporation ratified their action when it bought plaintiffs' stock for less than 18 per cent of its true value. It received the benefits. It cannot be heard to say now, if plaintiffs' charges are true, that Johnson and McCullough did not act for it.

For these reasons, this part of the motion must be, and is, DENIED.

7. The present stockholders are not indispensable parties defendant. In law, if they had been joined, a plea of prematurity by them would be good.

Defendant is a Delaware corporation. As such, it, its stockholders, and persons claiming against it are subject to the corporation laws of that State. *Christian v. Texas Gas & Power Corp.*, (D.C., N. D. of Texas, 1952) 14 F.R.D. 86. A footnote in that opinion quotes the Corporation Law of Delaware, Section 51, 8 Del. C. § 325, as follows:

> "NO SUIT AGAINST DIRECTOR OR STOCKHOLDER UNTIL JUDGMENT AGAINST CORPORATION: No suit shall be brought against any officer, director or stockholder for any debt of a corporation, of which he is an officer, director or stockholder, until judgment be obtained therefor against the corporation and execution thereon returned unsatisfied."

Naturally, the present shareholders' rights will be affected by the final outcome of this suit, either advantageously or adversely. But the same would be true in a suit brought, say, against American Telephone and Telegraph Company. No one would contend seriously that all of its multiple thousands of shareholders would be indispensable parties defendant in any suit brought by an outsider — plaintiffs are very much on the outside now — against that company. In the *Christian* case, *supra*, Judge Dooley passed upon a similar contention with this language:

> "Obviously if the stockholders of the dissolved corporation are indispensable parties this Court cannot retain jurisdiction and the case would have to be dismissed. The question is controlled by the law of Delaware, as the stockholders in the dissolved corporation necessarily accepted their interest as such subject to the law of the corporate domicile. A statute of that State preserves the suability

of a corporation for three years after dissolution and for that purpose, among others, the dissolution is in suspense for such time. This suit was filed about six months after the dissolution of defendant. The corporation in question consequently was still subject to suit when this case was filed just the same as it would have been before the dissolution. It continued to be a corporate entity for the purpose of legal actions. The fact that these stockholders took over the assets of the dissolved company makes no difference in the rule. The present contention would not seriously be made if the defendant were still a going corporation. In fact the law of Delaware is clear on this subject. Since despite the aspect of dissolution a Delaware corporation still remains a live entity as defendant in a lawsuit no strong reason is pointed out to make the stockholders indispensable parties in this case. The courts have often held that stockholders of a corporation, though same has become dormant through insolvency, dissipation of assets or voluntary cessation of business, or has been even formally dissolved, are not necessary parties to somewhat similar suits against the corporation, as in their capacity as stockholders they are sufficiently represented by their corporation, so much so in fact that often they will be bound by a judgment against the corporation. *The primary right of the plaintiff in this suit is against the defendant corporation. Only a secondary liability could be maintained against the stockholders.* Their responsibility comes from their voluntary act in receiving and appropriating corporate property subject to a trust for the benefit of claimants against the corporation. A suit against the corporation alone should suffice at least for an adjudication of the fact and amount of any liability to this plaintiff, and if he recovers then his recourse against the stockholders may be dealt with under proper process of the law. * * *"
(Emphasis supplied.)

As will be noted from the quotation, in that case the corporation had been dissolved, and its assets turned over to its shareholders, about six months before the suit

was brought. Here defendant has not been dissolved. It is still a going concern, although now in the last stages of liquidation. Its shareholders are liable to plaintiffs, if at all, only secondarily. They not only are not indispensable parties; they would be improper parties if they had been joined.

This part of the motion, therefore, must be, and is, DENIED.

8. As stated, the last point of defendant's motion is that there is a mis-joinder of parties plaintiff.

We think the complete answer to that argument is found in Rule 20(a), Fed. Rules Civ. Proc.:

> "All persons may join in one action as plaintiffs if they assert any right to relief jointly, severally, or in the alternative in respect of or arising out of the same transaction, occurrence, or series of transactions or occurrences and if any question of law or fact common to all of them will arise in the action."

Analysis of plaintiffs' claims shows clearly that they seek recovery from the *same* defendant, whose officers allegedly acted in the *same* manner as to all plaintiffs, at roughly the *same* time, and with substantially the *same* results. All plaintiffs seek the *same* relief on the *same* grounds, i. e. 1) actual fraud, or 2) constructive fraud and unjust enrichment. All claims present *common* questions of fact and law. Their right to relief, if they establish it, arises out of the *same* series of transactions.

A multiplicity of suits, all aimed at the *same* goal and utilizing the *same* protective measures, would result if they could not join together in one assault upon their adversary.

We not only think plaintiffs properly have joined in their action here; it would have been improper for them to have proceeded separately.(4)

For these reasons, and those given above, this part of defendant's motion, and the entire motion, are DENIED.

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(4) *Black v. Simpson*, (S. Ct. So. Carolina) 77 S.E. 1023, 46 L.R.A. (N.S.) 137:

"For the purposes of this discussion, the material facts set out in the complaint may be stated in few words. The defendant, Arthur O. Simpson, was a director and general manager of the Farmers' Fertilizer Company, in which the plaintiffs were shareholders. The defendant, while occupying this trust relation to the plaintiffs, conceived and entered upon a scheme of acquiring the entire corporate assets at much less than their actual value, by representing to each of the plaintiffs that the corporation was not prosperous, but financially embarrassed, and thus having assigned to him the shares of each of the plaintiffs at much less than their real value. The defendant successfully carried out his scheme by means of the false representations to the plaintiffs as to the condition of the corporation and the value of its property; and thus, in breach of his trust, induced the plaintiffs and other shareholders to sell him their stock. After thus acquiring all, or nearly all, the shares of stock, he sold 'the stock, franchises, real estate, buildings, and machinery' at much more than he had paid the shareholders, to his great profit, and to the great loss of the plaintiffs.

"In a case like this, where, according to the complaint, an officer of a corporation conceives and consummates a scheme to defraud the stockholders by deceiving them as to the value of the corporate property, and purchases the stock of each as a step in his scheme of frauduent acquisition, *it seems to us not only illogical, but most inconvenient and unjust, to require each stockholder to allege and prove the fraudulent scheme and the breach of trust in a separate action.* In many corporations there are hundreds, and in some thousands, of stockholders, many of them having small holdings and residing at a distance from the corporate enterprise. *To establish a rule which would deny to stockholders in such cases the right to unite in attacking such a breach of trust as is here alleged, and demanding an accounting by the trustee, would be a practical denial of justice.*" (Emphasis supplied.)

This brings us at last to consideration of the whole case, as presented by the pleadings and supporting papers, with particular regard to whether a preliminary injunction properly should issue. That matter has been submitted on those documents, no testimony having been taken.

In passing, we must note for the record that, because of the many problems confronting us, as shown by the very length of this opinion, with time being of such importance, we have been forced to proceed to our preliminary determinations herein under much pressure. Frankly, we have not read all of the many authorities cited in the voluminous briefs, but we have studied carefully what we consider to be the controlling cases and texts, in an effort to grasp thoroughly the essentials involved. That we do not mention some of the authorities cited in the briefs does not mean we have not considered them. We simply do not have the time to discuss and distinguish them from those we do cite as apposite, according to our best judgment.

It also should be clearly understood that, in ruling upon the case in its present posture, we are not expressing a final opinion on the merits. Necessarily, we must rule definitively upon the points now before us, but we emphasize that our findings at this stage of the matter are subject to revision, if facts not now before us require a change in our views as here expressed.

In our approach to this complicated matter, we have tried to maintain in proper balance, above the welter of facts, figures and prior decisions heaped upon us, the equities involved on both sides of the case. Inevitably, notwithstanding this plethora of legal and factual complexities, we find ourselves returning ultimately to the single, simple, inescapable fact: Plaintiffs received from defendant less than one-fifth of the actual value of their stock.

Serious charges of deliberate fraud are made. Those charges are vehemently denied. Their resolution must await decision until all of the evidence is heard. Plaintiffs bear the heavy burden of proving actual fraud, not just by a preponderance of the evidence, but beyond a reasonable doubt.(5) Nontheless, defendant admits in its answer that it began negotiations for sale of its timberlands — its most valuable asset — in April, 1954, only five months after it purchased the last of plaintiffs' stock. That could have occurred in all good faith, but at this point in the case it must be regarded as a circumstance rather strongly against defendant's position.(6) It is to actions, not just words, that we must look.

The first offers to buy, for $300 per share, admittedly were made by defendant's officers, and it was they who ultimately concluded the transactions by presenting them to their Board for approval, readily granted. These officers stood in a fiduciary, or quasi-fiduciary, capacity in their relation to plaintffs. It was their duty to advise plaintiffs fully, frankly and faithfully as to the true value of their stock.(7)

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(5) *Belcher v. Booth*, (La. Sup. Ct., 1927) 164 La. 514, 114 So. 116.

(6) We are informed in brief that defendant's President, in a discovery deposition taken on July 6, 1956, admitted that negotiations for sale of the timberlands began in January or February of 1954. However, since that deposition is not in the record, we do not consider it officially at this time.

(7) *Westwood v. Continental Can Co., Inc.*, (5th Cir.) 80 F. 2d 494:

"We are satisfied that when directors or other officers step aside from the duty of managing the corporate business under the charter for the benefit of stockholders, and *enter upon schemes among themselves or with others to dispose of the corporate business and to reap a personal profit at the expense of the stockholders by buying up their shares without full disclosure and at an inadequate price, there is a breach of duty. If the corporation ought to cease business, the stockholders may so decide and take steps to share the assets. If a favorable opportunity arises to sell out, the stockholders and not the managing officers are entitled to have the benefit of it*"

We find it hard to believe now, although our mind is open and we reserve final judgment, that plaintiffs knew much about the value of the stock, for otherwise

(7)—CONTINUED

See also *Markey v. Hibernia Homstead Association*, (La. App.) 186 So. 757:

It is generally held that, while a fiduciary relationship in a strict sense does not exist as between the stockholder of a corporation and an officer or director thereof, there is at least a quasi fiduciary connection between the parties, particularly where it is the duty of the director, by reason of special circumstances, to disclose matters within his knowledge In 13 American Jurisprudence, Section 1011, it is stated:

" 'A director or officer of a corporation actively engaged in the management of its affairs is, of course, in duty bound not actually to misrepresent the financial or other status of the corporate affairs. And if he does so, it has been held in various cases that the stockholder may rescind the sale or recover damages. *A sound and equitable rule has been taken that while a director or officer may not be a strict fiduciary for an individual stockholder from whom he purchases stock, yet if called upon for information concerning the affairs of the company or if he volunteers such information or becomes active in inducing the sale, he must speak fully and frankly and conceal nothing to the disadvantage of the selling stockholder.* Relief will be granted also to the stockholder where the purchasing director conspires to reduce the market price of the stock.'

"See, also, Fletcher's Cyclopedia of the Law of Corporations, vol. 3, sections 838 and 848. * * * * * *

"It is to be observed here that the defendant directors were not purchasing plaintiff's stock with their own funds. On the contrary, they were using the assets of the corporation for that purpose. It seems too plain for extended argument that, under such circumstances, they became trustees for all of the stockholders and that, if they concealed in bad faith any facts from any one of the persons affected by the plan they devised, they should be made to respond for their deceit.

"In Wood v. MacLean Drug Co., 266 Ill. App. 5, it was held that a purchase of a block of its common stock by a family-owned chain drug corporation is subject to rescission, in a suit by a stockholder from whom purchased, after a sale of the company's stores to another company for an amount much larger per share of common stock than that paid to the individual stockholder, where it was not disclosed to such

they surely would not have sold it for such a small fraction of its real worth. While the value may have changed substantially since 1953,[8] defendant's officers then must

(7)—CONTINUED

stockholder at the time of the purchase from her that two of the directors of her company, who were president and vice-president, respectively, were negotiating with other companies for the sale of the company's stores, and such fact did not appear of record. There, the court, in distinguishing between the relation of a director who is purchasing the corporate stock for his own account from an individual stockholder, and the fiduciary capacity in which he acts where he is endeavoring to purchase stock for the corporation itself, stated:

> "'In the instant case, when the board of directors of the MacLean Drug Company, acting as such board, bought Mrs. Wood's stock, not for the individual directors personally but for the MacLean Drug Company, a corporation, they were acting in their official capacities as directors, and under the law as stated in the Hooker case, (See 215 Ill. 444 (74 N.E. 445, 106 Am. St. Rep. 170)) we think they were acting as trustees for Mrs. Wood and were in duty bound to advise her of all of the facts; not having done so, she is entitled to recover the balance of the value of her 500 shares.'
>
> "The defendants also maintain that the conclusions drawn by plaintiff, with respect to the fraud which was allegedly perpetrated by them, are unwarranted because the correspondence which forms the basis of plaintiff's claim does not show that they misrepresented the facts. But fraud and deceit need not necessarily be founded upon misrepresentations. *On the contrary, a failure to state facts, where there is a duty to fully disclose them, is equally wrongful.*" (Emphasis supplied.)

See also *Seagrave Corp. v. Mount*, (6th Cir.) 212 F. 2d 389 (loc. cit. 396, 397:

"We are of the opinion, however, that the case is controlled by the fundamental principle of equity governing the personal transactions of fiduciaries in matters involving the interests of those to whom the fiduciary duty runs. As expressed by then Chief Justice Cardozo of the Court of Appeals of New York in Meinhard v. Salmon, 249 N.Y. 458, 164 N. E. 545, 546, 62 A.L.R. 1: 'Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an

have known, approximately at least, the true worth of the corporate assets, and consequently, the true value of its shares, either as a going concern or in liquidation. In

(7)—CONTINUED

honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions.'

"*A director is a fiduciary. So is a dominant or controlling stockholder or group of stockholders.* Pepper v. Litton, 308 U.S. 295, 306, 60 S. Ct. 238, 84 L. Ed. 281; Southern Pacific Co. v. Bogert, 250 U.S. 483, 491-492, 39 S. Ct. 533, 63 L. Ed. 1099; Wagner Elec. Corp. v. Hydraulic Brake Co., 269 Mich. 560, 566, 257 N. W. 884. *When the dual relationship of individual and fiduciary creates a conflict of interest the fiduciary relationship must prevail.* The Supreme Court said in United Copper Securities Co. v. Amalgamated Copper Co., 244 U. S. 261, at pages 263-264, 37 S. Ct. 509, at page 510, 61 L. Ed. 1119, that questions of internal management are ordinarily left to the discretion of the directors, and 'Courts interfere seldom to control such discretion intra vires the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or *where they stand in a dual relation which prevents an unprejudiced exercise of judgment;* * * *.' (Emphasis added.) This was repeated with approval by this Court in United Milk Products Corp. v. Lovell, supra, 75 F. 2d 923, 927. In Ashman v. Miller, supra, 101 F. 2d 85, 91, we again said:

'It is too plain for citation of authority that a director of a corporation cannot barter or sell his official discretion or enter into any contract whatever that will in any way restrict or limit the free exercise of his judgment and descretion in his official capacity, nor can he place himself under any direct and powerful inducement to disregard his duty to the corporation and its stockholders in the management of corporate affairs.' See also: Thomas v. Matthews, 94 Ohio St. 32, 43, 60, 113 N. E. 669, L.R.A. 1917A, 1068.

* * * *

"Although good faith on the part of the Directors and the disclosure of the material facts eliminate the question of actual fraud, *equity will still act to enforce the fiduciary obligation under circumstances amounting to constructive fraud.* Constructive fraud refers to acts which may have been done in good faith, with no purpose to harm the corporation, but which are done by one who has placed himself in

any event, deliberate fraud aside, there is enough shown dehors that question, we think, to justify us in preserving the *status quo* until trial on the merits has been had.

We refer to plaintiffs' alternative grounds for relief. Can it conscientiously be said that the consideration they got was serious, as required by Louisiana law, or that the transactions did not constitute an unjust enrichment to defendant? We shall answer those questions after first referring to the applicable Louisiana authorities, and others which are pertinent.

Article 2464 of the L.S.A. - Civil Code of Louisiana reads:

> "The price of the sale must be certain, that is to say, fixed and determined by the parties.
>
> "It ought to consist of a sum of money, otherwise it would be considered as an exchange.
>
> "It ought to be serious, that is to say, there should have been a serious and true agreement that it should be paid.
>
> "*It ought not to be out of all proportion with the value of the thing; for instance the sale of a plantation for a dollar could not be considered as a fair sale; it would be considered as a donation disguised.*" (Emphasis supplied.)

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(7)—CONTINUED

a position of conflict between a fiduciary obligation and his own private interests. In such a situation, by reason of the strict rule applicable to fiduciaries, equity will take appropriate action to prevent the harm resulting from such actions, regardless of the good intentions of the fiduciary. Levitan v. Stout, D. C. W. D. Ky., 97 F. Supp. 105, 117; Epstein v. United States, 6 Cir., 174 F. 2d 754, 765-766; Hyams v. Calumet & Hecla Mining Co., 6 Cir., 221 F. 529, 542-543." (Emphasis supplied.)

(8) The value at the time of the sale, not now, is the figure that controls. *Haas v. Cerami*, (La. Sup. Ct.) 201 La. 612, 10 So. 2d 61; *Ronaldson & Puckett Co. v. Bynum*, (La. Sup. Ct.) 122 La. 687, 48 So. 152.

In *Murray v. Barnhart*, (La. Sup. Ct., 1906) 117 La. 1023, 42 So. 489, 491, the Court said:

"'* * * At common law 'the slightest consideration is sufficient to support the most onerous obligation. The inadequacy, as has been said, is for the parties to consider at the time of making the agreement, and not for the court when it is sought to be enforced.' 9 Cyc. 365; A. & E. E. vol. 6, p. 694. *But under our law the consideration 'must be serious': 'it must not be out of all proportion with the value of the thing.'* Article 2464, Civ. Code. That article has special reference to the price of a sale, but the principle it involves is not peculiar to sales. It is a general principal of the civil law, and as old as the civil law itself. The example given by Ulpien as an illustration of it is not that of a sale, but, as happens, is that of a lease:

"'Si quis conduxerit nummo uno, locato nulla est; quira hoc donationis instar obtinet.' L. 46 Dig. f. f. Loc. Cond.; Pothier, Vente, Nos. 18 and 19; Merlin, Rep. Vo. Vente, § 1, art. 2, No. 1; Durantor, T. 16, No. 100; Troplong, Vente, No. 149; Marcade on articles 1591 and 1952, C. N.

"In such a case the presumption is that the parties did not intend that the *trifle* named should ever be paid at all, and the situation is looked upon as being as if no amount had been named. * * *" (Emphasis supplied.)

Later, in 1928, the same Court, in *Blanchard v. Haber*, 166 La. 117, 118 So. 117, 119, said:

"Under the civil law, as at common law, it is not necessary that the consideration received or to be received for incurring an obligation shall be an equivalent consideration. The question of adequacy of the consideration is a matter for the parties themselves to determine. But, while at common law any lawful consideration for a contract is deemed sufficient, the civil law requires that the *consideration must be serious and not altogether out of proportion to the obligation. Article 2464 of the Civil*

Code so provides, specifically, for the contract of sale; and in Murray v. Barnhart, 117 La. 1030, 42 So. 489, it was held that the doctrine of the civil law in that respect, being as old as the civil law itself, was applicable, not only to contracts of sale but to all other contracts." (Emphasis supplied.)

To the same effect are *Hirsch v. Rosenberg, et al.*, (La. App.) 14 So. 2d 331; *Shreveport Laundries v. Teagle*, (La. App.) 139 So. 563; *Spanier v. DeVoe*, (La. Sup. Ct.) 52 La. Ann. 581, 27 So. 174, and *D'Orgenoy v. Droz*, 13 La. 382. See also *Cali v. National Linen Service Corp.*, (5th Cir.) 38 F. 2d 235.

Pomeroy's Equity Jurisprudence, Vol. 3, Section 927, pp. 634-638, states:

"Although the actual cases in which a contract or conveyance has been canceled on account of gross inadequacy merely, without other inequitable incidents, are very few, yet the doctrine is settled, by a consensus of decisions and dicta, that even in the absence of all other circumstances, when the inadequacy of price is so gross that it shocks the conscience, and furnishes satisfactory and decisive evidence of fraud, it will be a sufficient ground for canceling a conveyance or contract, whether executed or executory. Even then fraud, and not inadequacy of price, is the true and only cause for the interposition of equity and the granting of relief.

* * * * *

"The following seems to be the true rationale of the doctrines concerning inadequacy of price: Whenever it appears that the parties have knowingly and deliberately fixed upon any price, however great or however small, there is no occasion or reason for interference by courts, for owners have a right to sell property for what they please, and buyers have a right to pay what they please. But where there is no evidence of such knowledge, intention, or deliberation by the parties, the disproportion between the value of the subject-matter and the price may be so great as to warrant the

court in inferring therefrom the fact of fraud. Such a gross inadequacy or disproportion will call for explanation, and will shift the burden of proof upon the party seeking to enforce the contract, and will require him to show affirmatively that the price was the result of a deliberate and intentional action by the parties; and if the facts do prove such action, the fact of fraud will be more readily and clearly inferred."

Applying these authorities to the admitted facts of this case, it is our opinion that the price paid by defendant for plaintiffs' stock was so trifling, so inordinately out of proportion to its true value, that no fair-minded person could say it was "serious". Its inadequacy "shocks the conscience."

Article 1965 of the L.S.A.-Civil Code of Louisiana, provides:

"The equity intended by this rule is founded in the Christian principle not to do unto others that which we would not wish others should do unto us; and on the moral maxim of the law that *no one ought to enrich himself at the expense of another.* When the law of the land, and that which the parties have made for themselves by their contract, are silent, courts must apply these principles to determine what ought to be incidents to a contract, which are required by equity." (Emphasis supplied.)

Restatement of the Law, on the subject of "Restitution", page 12, states:

"A person who has been unjustly enriched at the expense of another is required to make restitution to the other."

Hermann v. Gleason, (6th Cir.) 126 F. 2d 936, 940, held:

" * * * It is said that the action is equitable to the degree that it is based on a moral obligation to make restitution which rests upon a person who has received a benefit which, if restrained by him would result in inequity and injustice. Hummel v.

Hummel, 133 Ohio St. 520, 14 N. E. 2d 923. Under the doctrine of unjust enrichment, a defendant has something of value at the plaintiff's expense under circumstances which impose a legal duty of restitution. American University v. Forbes, 88 N.H. 17, 183 A. 860. See Wilson Cypress Co. v. Atlantic Coast Line R. Co., 5 Cir., 109 F. 2d 623; Ames' Lectures on Legal History, pages 149-166; Holdsworth's History of English Law, Vol. 8, page 92 et seq.; Lawrence on Equity Jurisprudence, Sec. 738."

On the basis of those authorities, it is also our opinion that defendant was unjustly enriched through its purchase of plaintiffs' stock, and ought to make restitution.

It may be that plaintiffs, and especially Mrs. Johnson, Mrs. Jennette, and Max Brown, by their knowledge of the facts and their subsequent actions, have knowingly ratified defendant's conduct so as to be estopped from prevailing in their claims. Nevertheless, we think they are entitled to their day in court to prove, if they can, their right to recover. Such serious matters ought not to be decided merely on the face of the papers.

The problem which has caused us our greatest concern, in determining whether a preliminary injunction should issue, is the large potential tax consequence with respect to defendant's liquidation. Naturally, that is a result which all parties, and the Court, wish to avoid.

We are informed by all counsel, however, that a conference was held at Washington, D. C., on August 2, 1956, between plaintiffs' and defendant's counsel, on the one hand, and an official of the United States Department of Internal Revenue, on the other, wherein the latter informally stated that the tax loss probably could be avoided if defendant's remaining assets are transferred to a Court-designated trustee, as stake-holder, with power to invest in short-term Government securities. We think

application for a formal ruling to that effect by all means should be made at once, and when received, the transfer should be made.

We thus conclude that plaintiffs are entitled to a trial. To protect their rights pending final determination, they likewise are entitled to have all assets remaining in defendant's hands, or subject to equitable control and distribution by this Court (including payments received and to be received, upon the balance of the purchase price for the timberlands, from the Gair Company), preserved for their benefit, should they succeed on the merits.

For these reasons, therefore, the preliminary injunction will be GRANTED. Its terms, and the amount of bond to be furnished by plaintiffs, will be fixed after due hearing, to be arranged shortly. The case will be set for trial on its merits at the earliest possible date.

THUS DONE AND SIGNED, in Chambers, in Shreveport, Louisiana, this 10th day of August 1956.

s/ BEN C. DAWKINS, JR.
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

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CIVIL ACTION

No. 5562

HATTIE A. JOHNSON, ET AL.

VS.

MANSFIELD HARDWOOD LUMBER COMPANY

* * * * * * * * * * * * * * * * *

BEN C. DAWKINS, JR., CHIEF JUDGE.

RULING ON PENDING MOTIONS

We have read with interest the respective briefs, and have noted the purport of the authorities cited.

Defendant seems determined to have the case disposed of upon its preliminary motions. From what we have seen thus far, we are even more determined to pass upon it finally only after all parties have had their day in Court. If there is a "bug under the chip", we want to see it. If not, we want to see that, too.

This ruling, of course, preserves to defendant inviolate all defenses it properly may raise upon the merits. By the same token, it enables plaintiffs to show, for once and for all, whether they have a valid case.

Accordingly, all pending motions by defendant are OVERRULED and DENIED. Plaintiffs' motion for appointment of a trustee will be GRANTED. Respective

counsel should contact the Court immediately to arrange a mutually convenient hearing date, as early as p[illegible], to

1. Fix the terms of the preliminary injunction; and,

2. Fix the amount of the injunction bond; and,

3. Arrange the terms of the order appointing a trustee; and,

4. Set a date for trial on the merits.

THUS DONE AND SIGNED, in Chambers, in Shreveport, Louisiana, this 6th day of September 1956.

s BEN C. DAWKINS, JR.
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF LOUISIANA SHREVEPORT DIVISION

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CIVIL ACTION

No. 5562

HATTIE A. JOHNSON, ET AL.

vs.

MANSFIELD HARDWOOD LUMBER COMPANY

* * * * * * * * * * * * * * * * * * *

BEN C. DAWKINS, JR., Chief Judge.

SUPPLEMENTAL REASON FOR RULINGS

In addition to the authorities mentioned in our opinion of August 10th, 1956, we relied considerably in our then, and subsequent, rulings upon the reasoning and precedents included in the decision of the Circuit Court of Appeals for the Tenth Circuit in *Black v Amen*, 234 F. 2d 12 (Federal Reporter Advance Sheet for Agust 13th, 1956), a copy of which was furnished to us by plaintiffs' counsel, the decision not having been published when we filed our opinion, and not cited by us at that time because we did not know then whether it was final. We note also, in *United States Law Week*, that an application for certiorari was filed in the United States Supreme Court on August 23rd, 1956, probably to be acted upon when that Court reconvenes on October 1st, 1956, or shortly thereafter.

That case and this one are remarkably similar, particularly with relation to the matters of fiduciary duties and laches. We agree with, and rely upon, that Court's reasoning and its method of doing equity. Especially do we concur in its holding that even if the action be purely equitable in its nature, and in the relief sought,

the rule of the State Statute of Limitations — not laches — ought to be applied.

True it may be that defendant here has changed its position since plaintiffs allegedly became aware that it would be liquidated, in July 1955. Yet, its change of position — the very thing that plaintiffs complain about — has resulted in no disadvantage to the corporation itself, which would have transferred all of its property, and have been dissolved, had it not been brought to a halt by this law suit. The change, rather, was intended to be to the considerable advantage of the remaining shareholders and to the substantial disadvantage, and at the expense, of these plaintiffs. Faced with such circumstances, we believe equity demands that we grant plaintiffs a full trial, preserving meanwhile such assets as remain for their benefit if they prevail on the merits.

It will not do, we think, for defendant's able and diligent counsel to complain that it is being "stripped naked, without funds even to defend itself." We are quite confident that those stockholders who allegedly confected the plan of liquidation will see to it that defendant continues the battle.

These conclusions, therefore, in addition to those already recorded, are being placed in the record to complete it.

THUS DONE AND SIGNED, in Chambers, in Shreveport, Louisiana, this 17th day of September 1956.

s BEN C. DAWKINS, JR.
UNITED STATES DISTRICT JUDGE

PRELIMINARY INJUNCTION

DISTRICT COURT OF THE UNITED STATES
WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

* * * * * * * * * * * * * * * * *

CIVIL ACTION No. 5562

HATTIE A. JOHNSON, ET AL.

vs.

MANSFIELD HARDWOOD LUMBER COMPANY

* * * * * * * * * * * * * * * * *

THIS CAUSE coming on to be heard upon the application of complainants for a preliminary injunction, and motion for appointment of a Trustee, due notice having been given the defendant, and the Court having considered the verified complaint and affidavits submitted by complainants the motion to dismiss for failure to state a claim, for failure to join indispensable parties defendant and for misjoinder of parties plaintiff filed by defendant, the verified answer and affidavits submitted by the defendant, the motion for new trial or rehearing filed by defendant, and the supplemental motion for a new trial or rehearing filed by defendant, and the affidavit and the letter attached thereto, the motion to dismiss for lack of jurisdiction and alternative motion to dismiss for failure to join indispensable parties defendant, filed by defendant subsequent to the issuance of the temporary restraining order dated August 17, 1956, the ruling of the United States Treasury Department, Commissioner of Internal Revenue, Tax Rulings Division, dated August 16, 1956, (which ruling was made pursuant to a petition filed with the Commissioner of Internal Revenue, a copy of which petition should be included in this record) and an oral ruling made at the request of the Court on September 14, 1956, by George M. Terry of the Office of Tax Rulings, Office of the Commissioner of Internal

Revenue, (which ruling Mr. Terry stated would be promply confirmed upon application made either by telegram or letter, a copy of which ruling when received should be included in this record) the Court being advised that a tax of approximately $1,500,000.00 would be incurred by the defendant if all of its assets are not irrevocably divested on or before September 25, 1956, and being further advised by him that this divesture of title could be accomplished by an order of the Court to the defendant that a transfer be made to the Trustee, who should be merely a stakeholder, or by some voluntary corporate act; and the Court having heard the argument of counsel and being of the opinion that the law and the evidence are in favor thereof, as stated in its Findings of Facts and Conclusions of Law filed herein on August 10, 1956, September 6, 1956, and September 17, 1956, NOW, THEREFORE:

IT IS ORDERED, ADJUDGED AND DECREED that a preliminary injunction be, and it is hereby issued herein, (ordering the defendant, Mansfield Hardwood Lumber Company, to irrevocably transfer unto the Trustee hereinafter named, title to and possession of all of its assets and property, real, personal and mixed, in its possession this day, said transfer to be made on or before the 24th day of September, 1956) it is further ordered, adjudged and decreed that should the defendant, Mansfield Hardwood Lumber Company, fail or refuse to make such irrevocable transfer, then and in that event, this order shall stand in lieu of such transfer and shall vest title in the Trustee of all such assets; subject to the further provisions of this decree.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that subject to the subsequent provisions of this decree, the Commercial National Bank in Shreveport, Louisiana, a national banking corporation, with its domicle at Shreveport, in said State, be and it is hereby appointed Trustee, to receive title to and possession of all

the assets of the defendant, Mansfield Hardwood Lumber Company, to be transferred as provided hereinabove, to hold the same, forever free of any claim or control, present or future, of the said defendant, Mansfield Hardwood Lumber Company, and to hold said assets until this litigation is completed and there is a final determination of the persons legally entitled to receive them and in what amounts, but which assets are in no event to revert to the defendant herein; provided, however, and notwithstanding any other provisions of this decree, in the event the injunction issued herein shall be dissolved by a judgment of this or any other Court prior to a decision on the merits, then and in that event, the title to such assets shall immediately vest in the stockholders of defendant, Mansfield Hardwood Lumber Company, as of this date, their heirs, legatees and assigns, subject to the further orders of this Court to effect delivery of such assets.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Commercial National Bank in Shreveport shall be a stakeholder of the property transferred to it under this decree; it is ordered to hold the property intact and has no authority to transact any business of any kind, not even to the extent of granting oil or gas leases to explore for minerals on any land transferred to it under the authority of this decree. Subject to prior approval of this Court, however, the Trustee may invest cash funds in its possession in short-term Government securities and may pay any known claims unpaid on the date of transfer, as well as any claims unknown on such date which may subsequently be legally proven.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the assets so transferred to the Commercial National Bank in Shreveport, shall be held by said Bank in trust, and said Bank shall pledge United States Government securities of the par value of $1,500,000.00 to secure the payment of said assets and the faithful performance of its duties as Trustee.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the preliminary injunction ordered herein is conditioned upon the complainants' filing, on or before September 20th, 1956, their bond, with corporate surety to be approved by this Court, in the sum of $30,000.00 for the payment of such costs and damages as may be incurred or suffered by defendant if it is found to be wrongfully enjoined.

THUS DONE and signed at Shreveport, Louisiana, on this the 19th day of September, 1956.

s BEN C. DAWKINS, JR.
UNITED STATES DISTRICT JUDGE

Filed September 19, 1956.

IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

* * * * * * * * * * * * * * * * *

CIVIL ACTION

No. 5562

HATTIE A. JOHNSON, ET AL.
vs.
MANSFIELD HARDWOOD LUMBER COMPANY

* * * * * * * * * * * * * * * * *

BEN C. DAWKINS, JR., CHIEF JUDGE.

RULING ON DEFENDANT'S MOTIONS TO COMPEL ANSWERS

We have read the briefs, and authorities cited, and have reached the following conclusions:

A. FACTS.

It is perfectly obvious that 1) the law firm of Booth, Lockard, Jack and Pleasant were consulted in their professional capacity by at least some of the plaintiffs concerning the subject matter of this case. This is shown by the letter, dated September 7, 1955, marked "Personal and Confidential", written by Mr. Jack to Klady & Brooke, and filed in the record by defendant. 2) Plaintiffs have not waived their privilege against disclosure of any information obtained by Booth, Lockard, Jack and Pleasant from plaintiffs, or from others, in their professional capacity. On the contrary, through their present counsel they have insisted upon the privilege being honored (Transcript of October 26, 1956, page 4, lines 2-6).

B. LAW.

1. In Louisiana, it is the duty of an attorney, without "his client's *express* consent", *not* to disclose "*any*

communication made to him *as such* legal adviser, by *or* on behalf of his client, or *any information* that he *may have gotten* by reason of his being such legal adviser" (R.S. 15:475).

2. This means that until the client's *express consent*" is first given directly to him, the attorney's lips are sealed.

3. The attorney should not be required at any time, and particularly in a discovery deposition situation such as this, to seek out his client, or former client, to determine whether such "express consent" will be given. Rather, the burden is upon the party who seeks to have the attorney make such disclosure to show that the client's "express consent" already has been given, before the attorney may be required to answer.

4. This privilege, under R.S. 15:475, extends not only to communications directly between the client and the attorney, but to "*any* information that he [the attorney] may have gotten" "on behalf of his client" because of the relationship. Here, this includes any information Booth, Lockard, Jack and Pleasant may have received, not only from Klady & Brooke, but from any other source. *Hickman v. Taylor*, 329 U. S. 495.

5. Moreover, even if the positive laws of Louisiana (R.S. 15:475, and Civil Code Article 2283) did not include such clear, unmistakable prohibitions against the types of disclosures here sought to be elicited, and notwithstanding the loose views on the subject apparently entertained in some jurisdictions (as in the authorities cited by defendants, plainly not apposite here), this Court, out of a fundamental respect for and adherence to the ethics of the legal profession, and absent an express waiver by the clients, would refuse to order these attorneys to answer the questions put to them by defendant's counsel, just as we would decline to instruct defendant's attorneys to answer questions which similarly might be put to them by plaintiffs' counsel.

6. We think Messrs. Lockard and Jack are to be commended for their refusal to answer the questions put to them by defendant's counsel. They properly have recognized, and refused to be swayed from, their sworn duty as members of an honorable and exalted profession, just as defendant's counsel would have done in the same or similar circumstances.

Defendant's motions to compel answers are totally devoid of merit. They are DENIED.

THUS DONE AND SIGNED, in Chambers, in Shreveport, Louisiana, this 17th day of December 1956.

s BEN C. DAWKINS, JR.
UNITED STATES DISTRICT JUDGE

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 16344

MANSFIELD HARDWOOD LUMBER COMPANY,

Appellant,

versus

HATTIE A. JOHNSON, ET AL.,

Appellees.

Appeal from the United States District Court for the Western District of Louisiana

(March 1, 1957.)

Before HUTCHESON, Chief Judge, and CAMERON and JONES, Circuit Judges.

HUTCHESON, Chief Judge: Filed on the 21st day of June, 1956, by appellees as former stockholders of the defendant, a corporation in liquidation, the suit was for the rescission of the sales to it by them of their shares aggregating 1156, and for an accounting.

Put forward in a lengthy complaint, the claim in brief was: that the company, through its president and vice-president, had fraudulently conceived and as fraudulently executed a scheme by and through which it had induced plaintiffs to sell their stock in the company for

$400 a share, an insignificant part of the $2000 a share which it was alleged was its true value; that the corporation was in liquidation, had already distributed to the stockholders, as shown on its books, large amounts of cash and was about to distribute to them its remaining cash and to convey to them its title to undivided interest in reserved minerals; that, unless a preliminary injunction was issued to hold matters in status quo, the defendant would divest itself of all its assets and properties and would thereby defeat, or at least seriously embarrass and delay, satisfaction of plaintiffs' claims. The prayer was for an interlocutory injunction and on final hearing that the sales be rescinded and a full accounting be made to them as stockholders.

The defendant moved to dismiss the complaint for failure to state a claim; failure to allege a prior tender; laches; and failure to join as indispensable parties the two officers referred to and the other stockholders. Subject to its motion, it filed a verified answer, denying all the allegations of fraud and overreaching, and alleging ratification of their sales by two of the plaintiffs and laches by all of them in not sooner bringing the action.

The district judge issued a temporary restraining order maintaining the status quo and renewed it from time to time until August 10, 1956, when, in a lengthy opinion, reported in 143 F. Supp. at 826, he fully canvassed and decided adversely to it the grounds put forward in defendant's motion to dismiss. On the basis of this decision and the supplemental reasons later filed by him on September 17th, he issued the preliminary injunction[1] which is the subject of this appeal.

[1] Reciting in it consideration of: the verified complaint and affidavits; the motion to dismiss; the verified answer and affidavits submitted by defendant; the defendant's motions for new trial or rehearing; the tax rulings of the Office of the Commissioner of Internal Revenue; the fact that the court was advised that a tax of approximately $1,500,000 would be incurred by the defendant if all of

In complete disregard of the principle that the appeal from the interlocutory injunction did not bring up the cause as a whole and that "the case, except for hearing on the appeal from the interlocutory order, is to proceed in the lower court as though no such appeal had been taken, unless otherwise specially ordered," Ex Parte National Enameling Co., 201 U.S. 156, *Lea v. Vasco Pro. Inc.*, 81 F(2) 1011; *Douglass vs. Pan American Bus Lines*, 81 F(2) 223; the defendant, instead of "pressing the cause to trial on its merits", and then bringing them up, *Douglass v. Pan-American supra*, at 225, and presenting here the sole issue available to it on this appeal, that the interlocutory injunction was improvidently and inequitably granted, has come here with a seventy-five page brief, with nearly fifty pages of it devoted to a discussion of the court's ruling on the motion to dismiss, which is not before us for decision.

We recognize, of course, that "if insuperable obstacles to maintain the bill clearly appear, it may be dismissed and the litigation determined", *Deckert v. Independent Corp.*, 311 U.S. 287. Here, however, instead of determining whether the injunction was improvidently granted, the defendant is undertaking to have this court

its assets were not irrevocably divested on or before Sept. 25, 1956; the necessity, therefore, of such irrevocable divestiture; and that this could be accomplished by either a voluntary act or an order of the court, appointing a trustee as stakeholder; the district judge ordered defendant to irrevocably transfer on or before September 24, 1956, all of its assets and properties in its possession to Commercial National Bank in Shreveport, as Trustee, and ordered the said trustee to receive title and possession thereof as stakeholder to hold until the litigation is completed and there is a final determination of the persons legally entitled to receive them. The trustee was required to pledge securities of the value of $1,500,000 and the issuance of the injunction was conditioned upon the complainants giving bond in the sum of $30,000.

determine whether the order denying the motion to dismiss was rightly entered,[2] an entirely different thing which is not before us.

The district judge, reserving until the trial his final opinion on the merits,[3] in a thorough-going effort to deal adequately with the motion to dismiss for the purpose of determining in connection with the prayer for a preliminary injunction whether it contained allegations which, if proved, entitled plaintiffs to some equitable relief, made it quite clear in his opinion: that substantial questions of law and fact existed; and that, on a balancing of conveniences, the complainants would suffer irreparable loss if the injunction did not issue, while defendant, if it did, would not. Regarding the principle declared in the Mytinger case, *supra*, at page 383:

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[2] Mytinger vs. Numanna, 215 F(2) 382; Mitchell vs. Penny Stores, 284 U.S. 576; Cone v. Rorick, 112 F(2) 894; and cases cited in the notes of decisions to Sec. 1292, Title 28, "Scope of Review" notes 251 to 284.

[3] "It also should be clearly understood that, in ruling upon the case in its present posture, we are not expressing a final opinion on the merits. Necessarily, we must rule definitely upon the points now before us, but we emphasize that our findings at this stage of the matter are subject to revision, if facts not now before us require a change in our views as here expressed.

"In our approach to this complicated matter, we have tried to maintain in proper balance, above the welter of facts, figures and prior decisions heaped upon us, the equities involved on both sides of the case. Inevitably, notwithstanding this plethora of legal and factual complexities, we find ourselves returning ultimately to the single, simple, inescapable fact: Plaintiffs received from defendant less than one-fifth of the actual value of their stock.

"Serious charges of deliberate fraud are made. Those charges are vehemently denied. Their resolution must await decision until all of the evidence is heard. Plaintiffs bear the heavy burden of proving actual fraud, not just by a preponderance of the evidence, but beyond a reasonable doubt.* * *" Johnson vs. Mansfield Hdw. Lumber Co., 143 F. Supp. 826, at 839.

> "On an appeal from a decree from preliminary injunction, the sole issue before the court is *whether the district court abused its discretion* and the merits of the controversy will be left open for further consideration and future determination." (Emphais supplied.)

As correct and controlling here, and agreeing with the district judge that the case should not have been dismissed for want of indispensable parties,[4] this court will not attempt to deal with or consider the first question presented in the briefs, whether the court erred in denying the motion to dismiss, but will direct its attention to and consider only the second question discussed, whether, as claimed by appellant, the district court, in granting the interlocutory decree, transcended its powers or abused its equitable discretion.

An examination of the record, in the light of the briefs and arguments of the parties, convinces us that the district judge did not exceed his powers in granting the injunction, and that he did not act other than, as a chancellor, he had a right to act—indeed ought to have acted. Though the district judge was troubled and did express grave concern over the form of the injunction, after full and careful consideration he concluded, and we agree, that, under the facts of this case, it was necessary, in order to preserve the equities and rights of the parties, for it to take the form it did.

In other circumstances than those prevailing here, it might well have seemed improvident, on a prayer for preliminary relief, to issue a mandatory injunction, divesting the corporation of its remaining undistributed properties. We think it clear, however, for the reasons hereafter briefly stated, that, under the undisputed facts

[4] Hudson v. Newell, 172 Fed(2) at p. 850; 174 F.(2) 546; Mackintosh v. Marks, 225 F(2) 211. Cf. Christian v. Texas Gas Co., 14 F.R.D. 8081.

in this case, the injunction, though mandatory in form, did nothing more in fact and in law than, but exactly the same as, the restraining orders had done, preserve the status quo, and that, under the peculiar facts, its issuance was not beyond, but well within, the equity powers of the court.

When the suit was filed, the defendant was in process of active liquidation under a plan to distribute all of its assets. It had already distributed much the greater part of them, and but for the court's restraining order then issued and thereafter renewed, and the preliminary injunction here appealed from, it would have distributed them all. Appointing a custodial trustee and requiring the defendant, in compliance with the tax ruling obtained as a result of conferences between defendant's counsel, the court, and the tax officers, to convey to it its undistributed properties and thus complete its distribution in liquidation,—a liquidation which for tax purposes had to be complete by September 25, 1956,—the order appealed from not only secured the plaintiffs' position against loss pending the litigation of their claims, but also operated to save both plaintiffs and defendant from an enormous and wholly unnecessary tax loss, which might otherwise have occurred.

We are in no doubt that, matters standing thus, the district judge, in giving the injunction the form it took, of divesting the defendant of its remaining assets to vest them in a custodial trustee, did nothing more than the corporation was endeavoring to do, but for this suit would have done, bring about a complete liquidation of its assets in favor of its stockholders within the time required to obtain the tax saving. In short, in bringing this about, we are of the clear opinion: that the district judge did nothing more than accomplish by mandatory divestiture what the defendant and all those interested in it wished accomplished; that there is no basis for a

claim that injury was thereby inflicted on, or resulted to, the defendant or any of its stockholders; or that, in adapting the flexible remedial procedures of equity to the situation presented, the court transcended its powers.

In addition, it must be kept in mind that the district judge advised the parties that he was in a position to give them an immediate trial within two or three weeks, and if the defendant had not been so determined to make its appeal from an interlocutory order serve as a vehicle for appealing the order denying its motion to dismiss, the matters would have long since been settled on the merits in the district court and on their way to, if not decided by, this court. Compare what is said in *Douglass v. Pan American Lines, supra.*

These facts, together with the fact that the defendant's own bank, where its moneys were already deposited, was appointed as trustee, that the bank was required to give full security for the funds, that the funds in its control are drawing interest, make it clear, we think, that it cannot be reasonably contended that the order appealed from was improvidently granted.

In *Pulitzer v. Houston Printing Co.*, 4 F.(2d) 927, the district judge, in denying an injunction where no injury was shown, said in part:

> "Equity sits for substance and not for shadow. * * * and while, in the popular adage, 'Straws may show the way the wind blows', equity has never yet issued its writ to protect either a straw man or a house of straw, and equity saves the wheat and fans the straw."

Upon the same considerations, we think it plain that, upon the undisputed facts of record here shown, and upon the principle alone of the balancing of conveniences, for the district judge to have refused to frame his in-

junction in the mandatory form it took would have been a sticking in the bark of form, a denial of the substance for the shadow.

The order appealed from is, therefore, AFFIRMED.

JUDGMENT

Extract from the Minutes of March 1, 1957

No. 16344

MANSFIELD HARDWOOD LUMBER COMPANY,

versus

HATTIE A. JOHNSON, ET AL.

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Louisiana, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the said District Court appealed from in this cause be, and the same is hereby, affirmed;

It is further ordered and adjudged that the appellant, Mansfield Hardwood Lumber Company, and the sureties on the appeal bond herein, Brown McCullough and Thomas W. M. Long, be condemned, in solido, to pay the costs of this cause in this Court for which execution may be issued out of the said District Court.

IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

* * * * * * * * * * * * * * * * * *

CIVIL ACTION No. 5562

HATTIE A. JOHNSON, ET AL.

vs.

MANSFIELD HARDWOOD LUMBER COMPANY

* * * * * * * * * * * * * * * * * *

BEN C. DAWKINS, JR., CHIEF JUDGE.

OPINION ON MERITS

We find it our hard duty to pass judgment upon a family schism of the first magnitude, resulting from the purchase of minority stock by a corporation through alleged fraud on the part of its officers and majority stockholders.

The crux of the case is that, had it not been for this suit, the majority — six people who proceeded to sell and liquidate the corporate assets immediately after the minority stock was bought, notwithstanding promises that this would not be done — would have reaped a profit for themselves, before taxes, of more than $3,400,000, at the expense of the minority, and in addition to nearly $6,000,000 rightly to be received by them in the liquidation for their own stock.

All persons involved are educated, cultured, refined. They have enjoyed, and still occupy, positions of prestige in their home communities. Until this tragic controversy arose, they appeared to be fairly congenial, at least on the surface.

Now, regrettably, they are publicly and irreconcilably divided into two warring camps. One group — the former minority stockholders — is convinced that its mem-

bers are victims of deliberate fraud perpetrated upon them by the majority. For their part, the majority resists and resents, with equal fervor, the charges made against them.

While the suit is one which ought not to have been necessary, and clearly should have been settled, the depth of feeling is such that compromise has not even been discussed. Consequently, this litigation must run it bitter course, for better or for worse.

The issues, as formed by the complaint and answer, are fully detailed in our earlier opinion, 143 F. Supp. 826, where, after disposing of various defensive motions, we granted a preliminary injunction. Briefly restated, the gist of the controversy is this:

Plaintiffs are Mrs. Hattie Johnson, Mrs. Jeanette Johnson Jennette, Mrs. Mamie Harrel, J. Allen Harrel, Mrs. Elizabeth Harrel Walker, Mrs. Ruth Harrel Mulkey, Mrs. Minette Velvin, Mrs. Alice S. H. Brown and Max Brown, residents of Louisiana and Arkansas. At the times in question, Mrs. Johnson Mrs. Harrel, Mrs. Velvin and Mrs. Brown were aged widows, largely dependent upon defendant's dividends for their livelihoods. J. Allen Harrel was blind.

On May 1, 1953, plaintiffs owned 1567 shares of defendant's stock. Defendant's officers, and those whom they allegedly represented or controlled, owned 2751 shares, being approximately 56 per cent of the 4836 shares then outstanding. Plaintiffs contend that, in 1952, or early 1953, defendant's officers conceived a fraudulent scheme, acquiesced in or ratified by the others whom they represented, whereby plaintiffs were to be induced to sell their stock to the company for grossly inadequate prices. They allege that, in furtherance of this scheme, they were told by these officers that defendant was about to engage in a long-range reforestation program upon its timberlands; that because of this, and their intention

to avoid double taxation by permitting larger salaries and bounses to be drawn by the officers, there would be little or no dividends paid to the stockholders for the next fifteen or twenty years; and that there were no plans or prospects for liquidation of the company. Plaintiffs further allege they first were offered $300 per share for their stock. After some negotiations, and because they believed and relied upon defendant's representations, as made by its officers, all but two of the plaintiffs sold their stock to the company for $350 per share, and the other two sold for $400 per share.

Plaintiffs contend that, almost immediately after the last stock had been purchased, in November, 1953, defendant began negotiations to sell the corporate assets, culminating in sales effected in the late spring of 1956, and a liquidation whereby the majority group, if undeterred, will realize more than $3,300 per share for their stock. Plaintiffs further contend that, if they had not been fraudulently induced, by the false representations made to them by defendant's officers, to sell their stock to the company, they would have received almost $2,100 per share for it, as against the $350 or $400 per share they actually were paid, being less than one-fifth of the actual liquidated value of the corporate assets. Accordingly, they prayed for an injunction to restrain defendant from distributing to its remaining stockholders the proceeds of the liquidation still remaining in its hands; further asking for a decree rescinding the sales of their stock, recognizing them as its equitable owners, and, thereafter, that an accounting be ordered.

As noted, the preliminary injunction was granted, and our action in that respect was affirmed by the appellate Court, 242 F. 2d 45. The injunction was mandatory in form, requiring that defendant transfer to a bank, as Court-designated trustee, its remaining assets, totaling approximately $1,300,000 in cash, plus certain other

properties. This was done and the funds have been invested by the trustee in short-term Government securities earning more than 3% per annum interest. The trustee now holds these funds and properties, secured by a pledge of Government bonds, subject to further orders of the Court upon final decision of the case.

In its answer, defendant has denied generally and specifically that it or its officers were guilty of the fraudulent conduct attributed to them by plaintiffs. It also has asserted various special defenses which will be particularized as we proceed.

After a full trial on the merits, lasting more than a week; having heard all of the parties and their witnesses; having considered the lengthy briefs (totaling approximately 300 pages), and the authorities cited; having studied the transcript of testimony and exhibits (some 1255 pages); having heard the oral arguments of respective counsel, lasting nearly three hours; and having reached our Findings of Fact and Conclusions of Law, we now set them down for the record. They represent to us the only result which justly could come from the evidence before us.

While there are some facts not in dispute, there are many more which are hotly controverted, especially as to what was said or not said, done or not done, known or not known, with regard to the purchase of plaintiffs' stock. In stating the facts we have found, our statements are based upon what we believe to be the truth, notwithstanding some testimony to the contrary. We also have drawn inferences, which we believe to be reasonable and correct, from the facts and circumstances in evidence.

We begin with the founding of the company, and proceed chronologically down to date, covering the important points as they developed.

The business that became Mansfield Hardwood Lumber Company was organized shortly after the turn of this century. It first was operated in South Arkansas, later moving its headquarters to Mansfield, Louisiana, thence to Shreveport. In 1940, it was chartered as a Delaware corporation, but by then its principal office, and most of its properties, were located in Louisiana.

Its founders were A. S. Johnson and N. D. Harrel. Johnson was married three times, first to Alice Farrow, their only child being H. Ben Johnson. After his first wife's death, A. S. Johnson married Mattie Harrel, sister of N. D. Harrel, but no children were born to this union. When Mrs. Mattie Harrel Johnson died, A. S. Johnson married Mrs. Hattie A. Johnson, and of this marriage was born but one child, Jeanette Johnson, who later married Charles L. Jennette. A. S. (Bud) Johnson and his sister, Mrs. Margaret Johnson Long, wife of T. W. M. (Tom) Long, were the only children of the marriage of H. Ben Johnson and Mrs. Eleanor Ewing Johnson, all three of whom survived him at his death in 1948.

The first A. S. Johnson served as President of the business from it beginning until his death in 1929, when his stock in the defendant company was inherited by his son, H. Ben Johnson, his daughter, Jeanette, and his widow, Hattie, the latter two receiving 668 and 547 shares, respectively. When H. Ben Johnson died, the stock he then owned (1296 shares) was inherited by his children, Bud and Margaret, and his widow, Eleanor, he previously having given them 1119 shares, making a total of 2415 shares.

N. D. Harrel was the husband of Mrs. Mamie Harrel, they being the parents of Tracy Harrel, J. Allen Harrel, Frank Harrel, Mrs. Elizabeth Harrel Walker and Mrs. Ruth Harrel Mulkey. Upon N. D. Harrel's death, his widow and children inherited from him a fairly substantial block of defendant's stock, some of which had

been acquired by defendant before 1953. Mrs. Mamie Harrel died in 1956, after this suit was filed, her estate now being represented by Cora Harrel, Administratrix. On January 1, 1953, she and her children, except Tracy Harrell, owned a total of 256 shares, her part being 131 shares. Mrs. Minette Velvin owned 51 shares, Mrs. Alice S. H. (D. K.) Brown, 10, and Max Brown, 65. Mrs. Velvin also died after the suit was filed, on April 23, 1957. Her estate is represented here by Drew Velvin, Executor.

Upon the death of A. S. Johnson in 1929, he was succeeded as president of the company by his son, H. Ben Johnson. When the latter died in 1948, his son, Bud Johnson, was elected as his successor. The First Vice-President, before and after H. Ben Johnson's death, was Brown McCullough, husband of Rosalind Kalmbach. He is the nephew of Mrs. Alice S. H. Brown, and a first cousin of Max Brown. In September, 1951, at the request of Bud Johnson, Max Brown resigned as Second Vice-President of defendant, and was succeeded by Tom Long, husband of Margaret Johnson. In 1953, Bud Johnson was about 34 years old, McCullough was 63, and Long about 35.

These officers served as such at all times pertinent to the issues involved here. They also acted as members of the Board of Directors, along with four others, three of whom were not active and not conversant with details of the company's affairs.

The actual, active management of defendant was conducted by the officers. Charles L. Jennette, J. R. Heard, Sr., and J. Allen Harrel served as Directors, but were not familiar with details of the business and had only vague ideas as to the extent or value of its properties. The only direct contact they had with it was at stockholders' and directors' meetings held once a year, and lasting only two to three hours.

The majority stock ownership, from 1952 until the suit was filed, was as follows:

Stockholder	*Number of shares*
A. S. (Bud) Johnson	531
A. S. (Bud) Johnson (subject to usufruct of Mrs. Eleanor Johnson	320
Mrs. Eleanor Johnson	751
Mrs. Margaret Johnson Long	493
Mrs. Margaret Johnson Long (subject to usufruct of Mrs. Eleanor Johnson)	320
Tom Long	7
Brown McCullough	322
Mrs. Rosalind K. McCullough	7
Total	2,751

At all times after 1948, Bud Johnson held the proxy of his mother, Mrs. Eleanor Johnson; Tom Long held his wife's proxy, and Brown McCullough held his wife's. The three officers, therefore, had full voting control of the company. Their proxy authority was unlimited and was never revoked. The only time these ladies voted their own stock was at a meeting held on September 26, 1955, when the then stockholders voted to liquidate the company.

During the years after it was moved from Arkansas to Louisiana, defendant gradually acquired a large acreage in timberlands. By May of 1953, and when its assets were sold, its total timberland holdings approximated 93,000 acres. It also owned lumber mills at Zwolle and Winnfield, Louisiana; retail outlets and lumberyards in five towns and cities in Louisiana, Arkansas and Texas; 100% of the stock of Reader Railroad, a public carrier line about 25 miles long, operating between Waterloo and Reader, Arkansas, and two subsidiary corporations; as

well as its general office building and other properties in Shreveport, the values of which will be shown later.

Although defendant's timberlands were carried on its books, during 1952 and 1953, at their original cost of a little less than $1,000,000, their actual value, well known to defendant's officers by no later than 1952, but not known to any of the plaintiffs except Max Brown, was about nine times that amount. Its total assets, according to its annual statement of June 30, 1952, which was circulated by the officers among its stockholders, were valued at $3,044.593.98. Its stock was closely held, was not traded on the open market, and had no established market value.

Defendant's record of dividend payments, per share of stock, from 1944 through 1955 was as follows:

1944	$ 6.00	1950	$13.00
1945	6.00	1951	12.00
1946	7.00	1952	5.00
1947	9.00	1953	4.00
1948	24.00*	1954	.00**
1949	12.00	1955	8.00

(* The size of this dividend is partly due to the company's having received that year $160,594.68, net, in insurance carried on the life of H. Ben Johnson.)

(** Apparently the company treasury had been exhausted by stock minority purchases made during 1953, described *infra*, some of which were partly paid for in 1954.)

By 1952, it became apparent to defendant's officers that its prospects for lucrative future earnings, commensurate with the intrinsic value of its land holdings, were not bright. This view was supported by the experience of many other companies similarly situated, whose condition was well known in the industry. Contemporaneously with these developments as to businesses such as defendant's, it became clear that large and growing paper

manufacturing companies, whose products were in steadily increasing demand, were interested in buying, or otherwise acquiring, at relatively high prices, large timber holdngs to satisfy the prodigious appetites of their mills for pulpwood. This was happening throughout the United States, and particularly in Louisiana, which has four sizeable paper mills located in the northern part of the State.

It was at about this time, we believe, that two events occurred which proved to be of major importance to this case. In fact, from what we have observed of the entire record, we are convinced that, happening as they did against the background of defendant's business prospects, these incidents triggered the course of action thereafter to be followed by defendant in its dealings with its minority stockholders.

Those events were:

1. In 1951-52, the stockholders of Frost Lumber Industries, a corporation domiciled in Shreveport, "captured" some of the greatly increased values of that company's extensive timberlands in this area, with large profits, through a tax-free merger of that company with Olin-Mathieson Chemical Corporation, which also later acquired the stock of Brown Paper Mill Company at Monroe, Louisiana;

2. Some time not long prior to August of 1952, defendant's President, Bud Johnson, was offered $5,000,000 by R. O. Martin, President of Roy O. Martin Lumber Company, Alexandria, Louisiana, for defendant's timberlands in the Zwolle, Louisiana, area, which constituted about 55% of defendant's total acreage, and perhaps one-half or less of its total land values. This offer was not accepted. Defendant's minority stockholders and directors were not advised that it had been received.

Those events served a) to appraise defendant's officers, (if they did not already know it, and we are

sure they did), that its whole timberlands had a sale value of eight or nine million dollars; and, b) to point to a ready market, willing and able to provide the means by which this great increment of value could be captured by defendant's officers and their immediate families.

It was because of these developments, we think, that defendant's officers formulated the scheme whereby they and theirs, to the exclusion of the minority stockholders, would reap the huge profits they knew were to be had from sale of defendant's assets and distribution of the proceeds to themselves.

At first, we think, it may not have been planned that Mrs. Hattie Johnson and Mrs. Jeanette Jennette would be excluded from sharing in the anticipated profits. This is indicated to some extent by two letters in the record, written to defendant's officers on August 29 and October 14, 1952, by C. L. Brooke, defendant's Certified Public Accountant. Therein he advised them as to possible tax consequences under the 1939 Internal Revenue Code, *vis-a-vis* stock swaps, stock sales, timberland sales, reorganization, etc., which then were under consideration. Plaintiffs never knew of the existence of these letters until a few days before the trial. In 1952 it was contemplated that the remaining minority shareholders' stock would be bought for $574 per share, not $300 as later offered, $350 or $400 as paid, or nearly $2100, its actual liquidation value.

After receiving these letters (before they were written the accountant had been instructed to assume that the corporation's total assets were worth in excess of $9,000,000), and having ascertained that heavy tax consequences would be incurred by them and their immediate families in a sale or liquidation under the 1939 Revenue Law (both the corporation and the shareholders were subject to capital gains taxes in an outright liquidation), defendant's officers concluded that they would embark on a program whereby the company would buy all of its

minority stock, including that of Mrs. Hattie Johnson and Mrs. Jennette, at prices which later would assure heavy profits to those remaining in the company, notwithstanding the tax consequences. A part of this plan was to acquire as much as they could of the other minority stock at about $300 per share, thereafter using whatever that figure might be as a starting point for bargaining with Mrs. Johnson and Mrs. Jennette.

The over-all strategy for accomplishment of the scheme was to apply a "dividend squeeze" upon all the minority stockholders in order to force them to sell their stock for considerably less than its value. This kind of pressure already had been exerted to a substantial extent well before direct stock-buying efforts were begun. As typical, but not necessarily exhaustive, examples of this, we note that the three corporate officers were drawing total salaries from defendant and its subsidiaries of about $67,000 per year, or about $13.85 per share for each of the 4836 outstanding shares. Of this amount, $10,000 was paid to Brown McCullough and $3600 to Bud Johnson, in addition to large salaries paid directly by defendant, in their capacity as officers of Reader Railroad. This company had gross earnings of $102,400 in 1952, but it was shown on the company's books as having lost $3715.35 that year. There was no limit upon the officers' expense accounts, the extent of which is not shown by this record, but in view of all else we have seen, they undoubtedly were handsome.

The officers, plus Mrs. Long, Mrs. Eleanor Johnson and Mrs. McCullough, together with two or three salesmen working for defendant, were partners in a phantom firm known as Shreveport Lumber Sales, located within defendant's own office and operated entirely at its expense, which the officers arranged to serve as a so-called brokerage agency for defendant, charging it a commission of 5% upon its sales. In 1950, 1951 and 1952 defendant's net sales exceeded $2,700,000 per year.

This meant that approximately $135,000 annually, or a little less than $28.00 per share for each of the 4836 shares outstanding, was skimmed off from defendant's income by the majority group, and put in its own pockets before funds available to pay dividends were realized. In other words, the officers' salaries and these "commissions", totaling about $200,000 per annum, had to be earned by defendant before the minority would get any dividends. The minority stockholders were never told that Shreveport Lumber Sales even existed, much less that it was charging defendants this commission. There was no resolution of record by defendant's stockholders or directors, authorizing the officers to enter into such a burdensome, dishonest arrangement.

Moreover, although defendant's net sales for 1951 amounted to $2,765,775, and for 1952 were larger, being $2,834,558, dividends paid to stockholders were reduced from $12.00 per share in 1951 to $5.00 per share in 1952. Defendant's net sales to the end of its fiscal year on June 30, 1953, amounted to $3,271,056. Yet dividends declared for that year were only $4.00 per share. There has been no showing of any extraordinary capital expenditures, or any substantial increase in operating expenses, during these years. It is possible, however, and fairly well indicated by the record, that the officers probably bought a large amount of timber from outside sources, instead of cutting from defendant's timberlands, thus maintaining their value for purposes of later liquidation. We can only conclude from these actions that the officers were accomplishing a double purpose by 1) applying dividend pressure, while at the same time 2) "laying in" the difference in order to have treasury surplus funds available from which defendant would pay for the minority stock whose purchase they were planning to effect. Defendant's accumulated surplus, in funds and property, totaled $2,244,075.97 on January 1, 1953. The minority shareholders equitably were entitled to a proportionate

interest in this accumulation of value, but the majority did not so regard the matter, using treasury surplus to acquire the minority stock interests.

While there were some unimportant differences in approach to the various minority stockholders, the general theme of the "dividend squeeze", applied principally by Bud Johnson and Brown McCullough during 1953, was to inform these people that the President and Second Vice-President were young men, with children of their own and with long futures ahead in the business; that they wanted to avoid double taxation by paying themselves higher salaries and bonuses; that they intended to engage in an intensive reforestation program, together with capital improvements to the lumber mills, extending over a period of many years, during which there would be little or no dividends paid to stockholders; and that these goals could be accomplished with the company's stock in the hands of the few persons constituting the majority. All minority stockholders were definitely assured that there was no plan for liquidation under consideration, and that none was contemplated for the future. The emphasis, instead, was upon "Bud's and Tom's" desire and intention to make lifetime careers for themselves and their children, in operating the business as a going concern.

Believing in, and relying upon these representations, all plaintiffs, except Mrs. Hattie Johnson and Mrs. Jennette, sold their stock, aggregating 262 shares, for $350 per share.

While all other minority shareholders were approached directly or through relatives, in soliciting purchases of their stock, defendant's officers used a different, clever and most effective method of acquiring the substantial holdings of Mrs. Johnson and Mrs. Jennette. The plan was that these ladies would be coerced into soliciting purchase of their stock by defendant, instead of vice versa

They and Charles Jennette lived together, with the Jennette children, in Shreveport. He was employed — not by defendant — at a small salary of less than $300 per month, the majority group having refused to give him or his wife a job with defendant, at a handsome salary, as had been done for Tom Long. The officers knew that these people were largely dependent for their living expenses upon dividends from defendant. The Jennettes, with their children and themselves to support, had a total adjusted gross income for 1951 amounting to $6951.34, of which $5573.99 was received in dividends from defendant. In 1952 their income was $5626.72, of which $2672.00 was from dividends. Mrs. Hattie Johnson had a total income of $5724.25 in 1951, of which $4564.33 came from defendant's dividends. In 1952, the figures were $3249.65 and $2188.00, respectively. C. L. Brooke, the accountant who worked for defendant and who has shown his primary loyalty to the majority since this case began, was also the accountant for Mrs. Johnson and the Jennettes. There is every reason to believe, and we do believe (especially considering that he later gave defense counsel a confidential letter from a lawyer then representing Mrs. Johnson and Mrs. Jennette, without their permission), that he informed defendant's officers of the extent to which these ladies were dependent upon defendant's dividends.

Therefore, instead of going directly to them and making an offer for their stock, as had been done with the other minority shareholders, and perhaps also because of the ill feeling previously existing between them, not long after June 1, 1953, Bud Johnson, for the first time in his life, visited Charles Jennette at the place where he worked in Bossier City, Louisiana. He told Jennette about the stock purchase program, informing him that they had just completed buying the Harrel family stock at $350 per share. Strong emphasis was placed on the various details of the "dividend squeeze", but no offer

to buy the stock of Jennette's wife or mother-in-law was made, for there was no need to do so. Defendant's officers knew full well what the response to this visit would be, and it was not long in coming. A few days later Mrs. Johnson went to Brown McCullough, her trusted adviser, to discuss the matter. She, a widow 67 years old, was almost desperate in her fear that the bulk of her income would be cut off. McCullough confirmed what Bud Johnson had told Jennette, but, as a part of the scheme, refused to advise either sale or retention of the stock, recommending that she consult C. L. Brooke. Not long afterward, she and Mrs. Jennette did so; whereupon, Brooke played the trump card for defendant. Because it is of such great importance in the case, and shows graphically to what dastardly lengths defendant and its officers went in their successful quest for the minority stock, with all of its sure profits, we quote directly the following revealing excerpts from Brooke's sworn admissions while on the stand as a witness for defendant:

"Q. Mr. Brooke, let me ask you this: Did either Mrs. Johnson or Mrs. Jennette in their conversations with you prior to the sale of their stock indicate to you, or say to you, that the officials of the Mansfield Hardwood Lumber Company had said there would be a curtailment, or little or no dividends paid by the company in the future?

"And didn't you answer:

"A. Yes, they did. That was one of the things that caused me to make that calculation, and that does bring up another point which I remember: that Mrs. Johnson did say this: She said, 'What am I going to live on?' I said, 'Here is your situation, Mrs. Johnson: You must realize this fact, as a minority stockholder that you can't very well vote dividends. Buddy, Brown and Tom, they have salaries. Between Buddy and Tom, they can take care of their mother. What do you think are the chances of them taking care of you if dividends are curtailed?' And she said she felt that was one

the things that she had to consider. It was take it or leave it. Frankly, when she came back and told me she got four hundred dollars, I told her she was a good saleman.

"That was your testimony, wasn't it?

"A. Yes, sir."

* * *

"They came down to my office. They said that Mansfield was buying up stock. They wanted to sell their stock. They wanted to know — wanted to talk to me about it and get my advice on it. So, I told them both that I would figure with them but I would not advise them. I said, in effect, over the years of my life I have seen too many cases where a decision is made upon the basis of known quantities and later on something else happens.

* * *

"During the course of our conversation, Mrs. Johnson or Mrs. Jennette, one of them, related it was their understanding that dividends would be curtailed. I don't remember whether they said for any period of years, long or short, or how much, but they would be curtailed.

* * *

"There is one thing I think the Court should know. Maybe I am wrong, Mr. Cook, but in this conference, as the question of what would Mrs. Johnson live on — what would she have to live with if she didn't get any dividends, or if the dividends were curtailed, whichever it would be, I told her that that was one thing she would have to take into consideration That was one of the purposes of making these calculations for her.

"I did tell her that she would have to take into consideration the fact that she and Mrs. Jennette together were minority stockholders and as far as I knew they would not be able to force the payment of dividends. From that standpoint there would be a possibility that they might sometimes be forced to sell their stock, to use the common idiom, frozen out.

"THE COURT: They might be forced to sell for less than they are being offered?

"THE WITNESS: Even less than they are being offered there."

That did it. After some further negotiations, defendant agreed to pay the ladies $400 per share for their holdings, partly in cash and the balance on terms of secured credit, the details of which will be covered later. This transaction was completed on November 14, 1953. With this purchase, defendant had acquired 1829 of the 2085 minority shares it had set out to capture. The holders of the remaining 256 shares, for various reasons such as income tax complications, sentiment, lack of need for the money, etc., did not care to sell, or were to sell later. Not to be outdone by them, however, and in order to entice these stragglers into possible capitulation somewhere down the line, there was placed on defendant's minute book a standing offer to buy the remaining shares at $350 each, with the Board of Directors being empowered to pay more than that figure.

Now the majority had well over two-thirds of all outstanding stock which they needed to put defendant in liquidation whenever they should choose to do so. Now their well-laid plans were approaching fruition, for they were ready at last to start peddling its assets, to accomplish in fact their scheme of capturing for themselves the great values they had known were there all along.

Instead of instituting an intensive reforestation program, as promised to plaintiffs, Bud Johnson immediately laid off the company's T S I (Timber Stand Improvement) crews, who would have performed that work, and whose wages were about $200 per week. The ink was hardly dry on the papers representing the last minority stock purchase made on November 14, 1953, when he started out on the long-planned selling campaign. In late January or early February of 1954, he made his first contact, with Charles E. Wilds, superintendent of Woods

Operation for the Brown Paper Mill at Monroe, Louisiana. A little later, on February 27, 1954, he made an appointment to meet with Earl Porter, an official of International Paper Company, on March 1, at Mobile, Alabama. International has two large paper mills in North Louisiana, at Bastrop and Springhill. On one occasion during the negotiations Johnson told Porter that defendant's timberlands were worth $10,000,000, and at another time he described their value at $100 per acre.

When he talked to Wilds, the discussion at the beginning dealt primarily with possible timberland exchanges, but when he saw that Wilds was not interested in this, he then told him in effect that defendant's timberlands were for sale. He testified that the purpose in contacting Porter not long thereafter was to promote competition between the two companies, hoping thereby to obtain better prices.

Nothing further was heard from Wilds, but negotiations with Porter continued, various plans being discussed, such as a possible merger, or with International purchasing all, or 80%, of defendant's stock, or outright purchase of its timberlands. About April 1, 1954, Porter tentatively indicated to defendant's officers that "it looks like about $8,000,000" would be a proper price for the timberlands. Bud Johnson replied, "That won't get it", and later on, after Brown McCullough had told him that $9,000,000 would buy them, Porter intimated he would recommend to his company that it pay $8,750,000. On April 9, 1954, evidently feeling that their sales efforts had proceeded so far that they could not get by with purchasing the remaining minority stock at $350 per share, and which might jeopardize the stock purchases already made, defendant's officers sent notice to these shareholders that the standing offer to buy at that price had been revoked, without explaining why.

After the officers showed considerable interest in the figures Porter had mentioned to them, International

sent timber cruisers to inspect defendant's lands sometime in May or early June of 1954. While this appraisal was proceeding, it developed that International, for its own reasons, was not interested in a merger or in buying 100% of defendant's stock, and could not obtain a "partner" to purchase 20%, on the 80-20 basis which its tax experts had recommended, so the negotiations settled down to a proposition of a straight-out sale of the timberlands to International. Meantime, during the first week in April, the officers, Mrs. Long, and Mrs. Eleanor Johnson had met and agreed to sell out.

On August 16, 1954, the Internal Revenue Code of 1954, including Sections 331(a)(1) and 337(a), became effective, providing that the double capital gains tax, on both the corporation and the stockholders in a liquidation, included in the 1939 Act, no longer would be applied, with only the liquidating shareholders being held liable. This new and unexpected development greatly benefited the majority's position, by cutting their potential tax liability almost in half, but according to their own testimony, they would have proceeded with sale of the corporate assets and liquidation even if this change in the tax law had not occurred.

On the opening day of the duck-hunting season, in early November, 1954, Bud Johnson and Tom Long were hunting at Caddo Lake, north of Shreveport. Evidently they had left word with Johnson's wife as to how they could be reached by telephone, and apparently were expecting a call from Earl Porter, for upon going to the Kool Point Lodge on the Lake, they received a message from Mrs. Johnson informing them that Porter wanted them to call him at Mobile. This was done. Porter advised them that he had recommended a higher figure to his company but that the maximum offer he was authorized to make was $7,700,000. This offer was turned down by Johnson and Long, while still talking to Porter, without consulting McCullough or any of the other stockholders.

majority or minority. The reason given for such peremptory action was that the offer was entirely too low.

Soon after that incident, a meeting of the majority was held, following which Bud Johnson went to Boston to discuss a possible sale of the timberlands with officials of the Southern Advance Bag and Paper Company, which operated a large paper mill at Hodge, Louisiana. That company was quite interested in acquiring the timberlands, so serious negotiations for their sale got under way.

By the early part of July, 1955, an agreement had been reached for defendant to sell its lands to Robert Gair Company, with which Southern Advance Bag and Paper Company had merged, for $8,632,530.34, of which $4,832,530.34 was paid in cash, the balance secured by a mortgage note, payable in five years, with interest at 3% per annum. Excepted from the sale were the mineral rights underlying approximately 60,000 acres, which were to be distributed to the remaining shareholders *pro rata*. A special meeting of defendant's remaining stockholders was held on September 26, 1955, at which unanimous approval was obtained for sale of the timberlands, and a plan of liquidation of the company's other assets. The sale to Gair was closed finally on May 25, 1956. The prices received for the principal assets were as follows:

Zwolle Mill	$ 75,000.00
Winnfield Mill	285,000.00
Stock of Mansfield Hardwood Lumber Company of Texas and Louisiana Builders Supply Company	500,000.00
Reader Railroad	39,100.00
Timberlands	8,632,530.34
Total	$9,531,630.34

The value of the mineral rights reserved for distribution to the remaining shareholders is not shown by

the record, but it is obvious that they, together with the amounts of cash realized, will bring the total value of the liquidation to more than $10,000,000.

On the basis of that figure, if plaintiffs, as the owners of 1567 shares, and the other minority stockholders whose shares were bought, totaling 262 (they not having joined in this suit, for reasons of their own), had not been fraudulently induced to sell their stock, they would be entitled to receive approximately $2068 per share, less, of course, the amounts they have received already. This figure is the quotient of $10,000,000 divided by the original 4836 shares. Unless plaintiffs succeed in having the sales of their stock rescinded, and are recognized as its equitable owners, the remaining 3007 shares, 2751 of which are held by defendant's officers and their immediate families, will receive approximately $3325 per share, before taxes, or about $1257 per share more than they would have gotten had plaintiffs not been eliminated as stockholders. Thus the majority collectively would profit from their own misdeeds, at the expense of plaintiffs and the other minority shareholders who sold, by some $3,458,007.00. They would get this amount over and above $5,689,068.00 they legitimately should receive, being $2068 for each of their 2751 shares.

Meantime, when the story of the proposed sale to Gair appeared in the newspapers, in late July of 1955, typical of the reactions of the former minority shareholders were those of Max Brown and Allen Harrel. Brown immediately drove from Zwolle to Shreveport and presented Bud Johnson with a check for the amount he had received for his stock, asking that he and the others who had sold be permitted to repurchase their stock and share in the liquidation. Allen Harrel, who has been blind since early manhood, wrote Johnson a letter, which was so spontaneous and eloquent in its expression that we quote it in full:

"Mr. A. S. Johnson
1166 Louisiana Avenue,
Shreveport, La.

"Dear Bud:

"In view of the statements and the promises that you made to me at the time that you were trying to obtain our stock in M. H. L. Co. I was not only surprised but virtually dismayed to learn that you are now in the process of liquidating the company at an enormous profit to those that are left in the company. The statements referred to are that you wished to obtain this stock so that you could better cope with the tax situation by absorbing most of the earnings by paying it out in salaries and in that way avoid double taxation, that you and Tom were both young and both had children that would carry on the business and it would never be sold or liquidated, also because of the first reason mentioned that you would pay little or no dividends for a long time to come. One promise I especially remember was that you would not offer or pay anyone more than you were going to pay us. This promise was violated soon after you made it. These circumstances forced us to accept your offer and let you have what stock we had left. I feel that we have been wronged by your action in this matter and you are morally obligated to do something about it. The honorable thing to do would be for those of you that are left is to agree to compensate us for the sacrifice that we made in letting you have the stock. The company as it is now is virtually a family affair so am sure that it would be an easy matter for you to get together on something like this. The price that you are getting for the company would enable you to do this and still leave all of you more than you could ever use and in the long run feel that your conscience would be a lots clearer than it will ever be if you do not do something about it. I am sure that it can be worked out from a tax angle also when the Revenue Department is informed that this is a way of taking care of those that sold because of statements and promises that you made. I do not know if you

realize just how the M. H. L. Co. came into existence or not but it was first started back in 1901 when after your grandfather, Mr. Johnson failed in the mercantile business here my father and his sister, who was the wife of Mr. Johnson, put up money to start the Lewisville Lumber Co., they later moved to Stamps and thence to Louisiana. Both men that originally started this company have widows and children living and are certainly entitled to a better deal than they have gotten under the deal that they were virtually forced to make with you. I hope that after you reflect over this matter and then consider the part that my father and Mr. Johnson had in bringing the M.H.L. into being, and promoting it to the point where their successors took over, you and those connected with you will decide to do the right thing about it. Please let me hear from you as soon as convenient for you to do so. Personal regards to Brown, Tom and yourself.

"Your very truly,

"J. A. Harrel."

Both Brown and Harrel immediately were turned down by Johnson, who tried to make it appear that what had happened was as if the company unexpectedly had "struck oil" on its properties — in suddenly discovering values never before known to exist. This response, in all of its untruthfulness, its grasping greed, and its moral bankruptcy, confirms in full measure our appraisal of the conduct of defendant's officers toward the minority. If, indeed, they had never known about the great value defendant's timberlands possessed, suddenly found so soon after acquiring plaintiffs' stock for a fraction of its liquidation worth, and if their motives were as pure as they would have us believe, they surely then would have done the decent thing by telling plaintiffs, in effect, "When we bought your stock, in all good faith we did not know how valuable the timberlands were, and we did not intend to sell. Now, however, just a few months later, we have a chance to sell at a handsome price. To prove

our sincerity from the start, we want you to come back into the company, for there is more than enough for everyone to share." Instead, the response was as decribed, and to us it is as strong a proof as any other evidence before us that these officers had meant to defraud the minority from the beginning. No other conclusion is admissible. We must find, therefore, that defendant's officers have been proven guilty of fraud, not merely by a preponderance of the evidence, but beyond a reasonable doubt.(1)

Human nature, with all of its foibles, being as it is, we find it hard to determine by just what process of rationalization defendant's officers anesthetized their conscience against the full implication of what they were doing. From all we know of them,(2) they otherwise are men of acumen and integrity. There is little question that Bud Johnson, the third-generation President, was the prime actor, the driving force, in all of this, but McCullough and Long went along with him in everything that was done. Probably they mistakenly regarded the matter as an arm's-length transaction in which they were free to drive a hard bargain, to use the "morals of the market place",(3) in their representations to plaintiffs. They and their predecessors had been in complete charge of defendant for so long that they unconsciously may have regarded the minority as non-productive nuisances, to be dealt with as such. They may have felt that, by tossing them a sop, the minority would not take the trouble to uncover the facts or have the courage to bring a suit, in effect against their own relatives, in vindication

(1) *Belcher v. Booth*, 164 La. 514, 114 So. 116, *American Guaranty Company v. Sunset Realty & Planting Company*, 23 So. 2d 409, 430.

(2) And as attested by character witnesses for whom we have the highest regard, but who admittedly knew little or nothing of the facts in this case.

(3) Chief Justice Cardozo of the Court of Appeals of New York, in *Meinhard v. Salmon*, 249 N. Y. 458, 164 N.E. 545, 546, 62 A.L.R. 1.

of their rights. Or, it may have been a question of sheer blind cupidity. Whatever it was, no chancellor in good conscience can allow their offical action, directly in defendant's behalf and indirectly in their own, to stand unrebuked and unavoided.

Defendant's counsel, in brief, have argued that there are five essential ingredients which must be proven in order for a contract to be voided on grounds of fraud.(4) They are:

1) A false representation;

2) In reference to a material fact;

3) Made with knowledge of its falsity;

4) With intent to deceive; and

5) With action taken in reliance upon the representation.

We accept counsel's contention as a sound statement of law, previously followed by this Court(5) and by the Court of Louisiana,(6) and as directly applicable here. It is clear, in the light of the facts detailed above,(7) that all of these five elements have been proven by plaintiffs to the hilt; and that, unless one or more of the special defenses are good, plaintiffs are entitled to the equitable relief they seek.(8)

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(4) Citing *Pence v. United States*, 316 U.S. 333, 62 S. Ct., 1080, 1083, 86 L. Ed. 1510.

(5) *Rountree v. United States*, 49 F. Supp. 840.

(6) *Garnier v. Aetna Insurance Company*, 181 La. 426, 159 So. 705, 707; *American Guaranty Company v. Sunset Realty & Planting Company, supra.*

(7) In determining the facts, as related, we have looked to what was done, as well as to what was or was not said. "Behavior rather than words among men and women is most significant in ascertaining intent." *Speed v. Transamerica Corporation*, 99 F. Supp. 808, 821.

(8) *Westwood v. Continental Can Co., Inc.*, 5 Cir., 80 F. 2d 494, 498:

"We are satisfied that when directors or other officers step aside from the duty of managing the corporate business

Moreover, even if defendant's officers had not been proven guilty of actual fraud in the many respects shown, defendant still would be liable for breach of the fiduciary obligations of its officers, in failing to advise plaintiffs fully, frankly and faithfully as to the important, material facts which were in the officers' possession. This amounted to constructive fraud.(9) The Fifth Circuit Court of

(8)—CONTINUED
under the charter for the benefit of stockholders, *and enter upon schemes among themselves or with others to dispose of the corporate business and to reap a personal profit at the expense of the stockholders by buying up their shares without full disclosure and at an inadequate price, there is a breach of duty. If the corporation ought to cease business, the stockholders may so decide and take steps to share the assets. If a favorable opportunity arises to sell out, the stockholders and not the managing officers are entiled to have the benefit of it.*" (Emphasis supplied.)

The Court went on to declare that such action is a violation, not only of the private rights of the stockholders, but of *public policy*. 80 F. 2d 498.

(9) *Guth, et al. v. Loft, Inc.*, (S. Ct. Del.) 5 Atl. 2d 503; *Markey v. Hibernia Homestead Association* (La. App.) 186 So. 757, 763, and authorities cited, quoted at length in our former opinion at 143 F. Supp. 839; *Zahn v. Transamerica Corporation*, 3 Cir., 162 F. 2d 36, 42, 43; *Seagrave Corporation v. Mount*, 6 Cir., 212 F. 2d 389, 396, 397; *Pepper v. Litton*, 308 U. S. 295, 306, 60 S. Ct. 238, 84 L. Ed. 281; *Speed v. Transamerica Corporation, supra; Lebold v. Inland Steel Company*, 7 Cir., 125 F. 2d 369.

Some of the material facts which admittedly were not disclosed to plaintiffs by defendant's officers, detailed above and here briefly recapitulated, are:

1) The $5,000,000 offer, for 55% of defendant's timberlands, made by R. O. Martin to Bud Johnson in 1952;

2) The instructions given to C. L. Brooke, in 1952, to assume that defendant's assets possessed a value in excess of $9,000,000;

3) The opinion of W. C. Postle, defendant's Chief Forester, in 1953, that its timberlands then had a market value "in the neighborhood of a hundred dollars an acre", which the officers knew about;

4) The letters containing tax advice, written by Brooke on August 29 and October 14, 1952, wherein contem-

Appeals in *Commercial National Bank in Shreveport v. Parsons*, 144 F. 2d 231, 238-239, had the following to say on this subject:

"Where the directors of a failing bank form a new bank and in effect pledge to themselves every asset

(9)—CONTINUED

plated plans for sale of defendant's assets, liquidation, merger, stock sales, etc., were discussed;

5) The officers' secret consideration of various plans of liquidation, reorganization, merger, etc., before the stock-buying program was begun.

See also 36 C. J. S. 746, verbo "Fiduciary":

"* * * It is a well-settled equitable rule that anyone acting in a fiduciary relation shall not be permitted to make use of that relation to benefit his own personal interest, except with the full knowledge and consent of the other person, and such other person must be in possession of all his powers before he can be bound by that knowledge or consent. *When a fiduciary relation is established between parties, courts of equity scrutinize very closely any transaction between the parties by which the dominant party secures any profit or advantage at the expense of the person under his influence. All transactions between parties in this relation are presumptively fraudulent and void, and the burden of proof is on the party asserting validity with respect thereto.*" (Emphasis supplied.)

See also 37 C. J S. 211, *et seq.*, verbo "Fraud", §2:

"Constructive fraud is a breach of legal or equitable duty which, irrespective of the moral guilty of the fraud feasor, the law declares fraudulent because of its tendency to deceive others, to violate public or private confidence, or to injure public interests. Neither actual dishonesty of purpose nor intent to deceive is an essential element of constructive fraud.

* * *

"Constructive fraud usually arises from a breach of duty where a relationship of trust and confidence exists.

* * *

"A fiduciary relation exists: Wherever confidence on one side results in superiority and influence on the other side: where a special confidence is reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing the confidence: where confidence is reposed and accepted, whether the origin is, moral, social, domestic, or merely personal: or where a person has knowledge and authority which he is bound to exercise for the benefit of another person."

of the old bank, a court of equity should scrutenize the contract with great care and strike down every oppressive and overreaching provision. *This is true even though the stockholders ratified the contract, because the parties were not on an equal footing and the directors occupied a position of trust and confidence.* The old shareholders were given the option to take stock in the new bank; but for many of them doubtless this was impossible, as very few availed themselves of the option. The contract should have been drawn so as to treat both groups fairly. *The directors had the advantage of an intimate knowledge of the old bank's condition, which the ordinary stockholders did not have. A hard bargain driven by fiduciaries in such circumstances is presumed to be fraudulent and void.* 25 C. J., 1118, 1119, 1120. The law of fiduciaries would be futile if it lacked the capacity to correct abuses arising out of the relation of trust and confidence existing between the directors of a corporation and its stockholders." (Emphasis supplied.)

Another ground fully justifying recovery by plaintiffs under Louisiana law, and established by undisputed facts, is that the consideration they received for their stock — less than 20% of its liquidated value — was not serious, within the meaning of that term as expressed in the L.S.A. - Civil Code, and as interpreted by the Louisiana jurisprudence.(10) In this connection, the evi-

(10) Article 2464 of the L.S.A. - Civil Code of Louisiana reads in pertinent part:

"It [the price of the sale] ought not to be out of all proportion with the value of the thing * * *."

In *Murray v. Barnhart*, 1906, 117 La. 1023, 42 So. 489, 491, the Court said:

"* * * At common law 'the slightest consideration is sufficient to support the most onerous obligation. The inadequacy, as has been said, is for the parties to consider at the time of making the agreement, and not for the court when it is sought to be enforced.' 9 Cyc. 365; A. & E. E. vol. 6, p. 694. ***But under our law the consideration 'must be serious': 'it must not be out of all proportion with the value of the thing.'*** Article 2464, Civ. Code. That article has special reference to the price of a sale, but the principle it involves

dence shows that the value of defendant's assets, when the remaining stockholders voted to liquidate in 1955, upon their actual sale in 1956, had not changed materially from those existing in 1953, when plaintiffs' stocks were bought.(11)

Pomeroy's Equity Jurisprudence, Volume 3, Section 927, pp. 634-638, declares:

(10)—CONTINUED

"is not peculiar to sales. It is a general principle of the civil law, and as old as the civil law itself. The example given by Ulpien as an illustration of it is not that of a sale, but, as happens, is that of a lease:

"'Si quis conduxerit nummo uno, locatio nulla est: quira hoc donationis instar obtinet.' L. 46 Dig. f. f. Loc. Cond.; Pothier, Vente, Nos. 18 and 19; Merlin, Rep. Vo. Vente, § 1, art. 2, No. 1; Durantor, T. 16, No. 111; Troplong, Vente, No. 149; Marcade on articles 1591 and 1592, C. N.

"In such a case the presumption is that the parties did not intend that the *trifle* named should ever be paid at all, and the situation is looked upon as being as if no amount had been named. ***" (Emphasis supplied.)

Later, in 1928, the same Court, in *Blanchard v. Haber* 166 La. 1014, 118 So. 117, 119, said:

"Under the civil law, as at common law, it is not necessary that the consideration received or to be received for incurring an obligation shall be an equivalent consideration. The question of adequacy of the consideration is a matter for the parties themselves to determine. But, while at common law any lawful consideration for a contract is deemed sufficient, the civil law requires that the *consideration must be serious and not altogether out of proportion to the obligation. Article 2464 of the Civil Code so provides specifically, for the contract of sale; and in Murray v. Barnhart, 117 La. 1030, 42 So. 489, it was held that the doctrine of the civil law in that respect being as old as the civil law itself; was applicable, not only to contracts of sale, but to all other contracts.*" (Emphasis supplied.)

To the same effect are *Hirsch v. Rosenberg*, La. App., 14 So. 2d 331; *Shreveport Laundries v. Teagle*, La. App., 139 So. 563; *Spanier v. DeVoe*, 52 La. Ann. 581, 27 So. 174, and *D'Orgenoy v. Droz*, 13 La. 382. See also *Cali v. National Linen Service Corp.*, 5 Cir., 38 F. 2d 35.

(11) *Haas v. Cerami*, 201 La. 612, 10 So. 2d 61; *Ronaldson & Puckett Company v. Bynum*, 122 La. 687, 48 So. 152.

"Although the actual cases in which a contract or conveyance has been cancelled on account of gross inadequacy merely, without other inequitable incidents, are very few, yet the doctrine is settled, by a consensus of decisions and *dicta*, that even in the absence of all other circumstances, when the inadequacy of price is so gross that it shocks the conscience, and furnishes satisfactory and decisive evidence of fraud, it will be a sufficient ground for cancelling a conveyance or contract, whether executed or executory. *Even then, fraud, and not inadequacy of price, is the true and only cause for the interposition of equity and the granting of relief.*

* * *

"The following seems to be the true rationale of the doctrines concerning inadequacy of price: Whenever it appears that the parties have knowingly and deliberately fixed upon any price, however great or however small, there is no occasion or reason for interference by courts, for owners have a right to sell property for what they please, and buyers have a right to pay what they please. But where there is no evidence of such knowledge, intention, or deliberation by the parties, the disproportion between the value of the subject-matter and the price may be so great as to warrant the court in inferring therefrom the *fact* of fraud. *Such a gross inadequacy or disproportion will call for explanation, and will shift the burden of proof upon the party seeking to enforce the contract, and will require him to show affirmatively that the price was the result of a deliberate and intentional action by the parties; and if the facts do [not] prove such action, the fact of fraud will be more readily and clearly inferred.*" (Emphasis supplied.)

While vigorously denying that defendant's officers committed fraud, either active or constructive, in their dealings with plaintiffs, defendant's counsel argue alternatively, and at length, that defendant still may not be held liable because there was no resolution of record, by its stockholders or directors, authorizing the officers to do what they did; nor was anything done by the corpor-

ation itself which ratified their action. In other words, they say that defendant's officers committed no fraud, but IF they did, it was *ultra vires* and defendant is not liable because it had not given them prior authority to defraud, and did not later ratify their misdeeds, either expressly or impliedly. This is indeed a tenuous argument, unsupported in fact and reprobated by the weight of legal authority.

The argument is factually inaccurate in that the record shows, without dispute, that defendant's officers were in complete control of defendant, with apparent authority to do anything they pleased. They *were* the company, as shown by Bud Johnson's testimony:

"Q. Is it your testimony, Mr. Johnson, that you didn't think the Board of Directors of Mansfield would be interested in the fact that you had been receiving communications from a tax accountant referring to the possibility of a liquidation of Mansfield, such as was accomplished in the Frost-Olin transaction?

"A. That was never brought before the Board of Directors — never brought before the stockholders. We who were in the active management of the company never gave it any thought whatsoever. Consequently, it was not brought up.

"Q. You don't think your Board of Directors was in active management of your company?

"A. Not from operating.

"Q. Whom did you have in mind when you said active management of the company?

"A. Those who were in the operation of the company, working with it every day.

"THE COURT: You mean the officers?

"THE WITNESS: Yes, sir.

"BY MR. WOODS.

"Q. Yourself, Mr. McCullough and Mr. Long?

"A. Yes, sir."

They not only had apparent authority, but had actual authority by their ownership and proxy control of more than 56% of the stock. On September 15, 1953, with full knowledge of the fraud they had committed against the other minority stockholders, and were about to commit against Mrs. Hattie Johnson and Mrs. Jennette, they voted these majority stock interests in favor of approving the company's purchase of all stock theretofore acquired, and to authorize the Board to approve purchase of Mrs. Johnson's and Mrs. Jennette's stock a little later. Defendant thereby expressly ratified all that was done, for the knowledge of its officers and minority stockholders was its knowledge. Moreover, defendant still ratifies the officers' conduct toward the minority by its insistence, before and since this suit was brought, that its purchase of the stock was valid, binding and final.

Legally, if defendant's argument were correct, it would be impossible for any one, stockholder or otherwise, to recover from a corportation on the ground of fraud committed by its officers or agents, because no group of stockholders or directors would be foolish enough expressly to authorize or ratify such fraud. The correct rule of law, applicable here, is found at 13 American Jurisprudence 1050, *et seq.*, verbo "Corporations", § 1125:

> "*Fraud and Misrepresentations.* — The general rule that a principal is liable for the fraud and misrepresentation of his agent while acting within the scope of his authority or employment is fully applicable to corporations. Corporations may be held liable for the fraud and deceit of their officers and agents acting within the scope of their corporate authority or employment. It is true as a mere legal entity a corporation can have no will, and cannot act at all, but in its relations to the public it is represented by its officers and agents, and their fraud in the corporate course of dealing is in law the fraud of the corporation. *What is more, a corporation is not relieved from liability for the fraud-*

ulent acts of its officers within the apparent scope of his authority by the fact that the officer in committing the fraud is acting for his own benefit and the fact that the corporation does not profit by it. The reason given for the corporation's liability in such case is that although the fraud is for the officers own benefit, the officer is placed in such a position by the corporation that as its agent he has the power to commit the wrong, and therefore it should bear the burden of his wrongdoing." (Emphasis supplied.)

The Fifth Circuit Court of Appeals in *Kohler v. Jacobs*, 138 F. 2d 440, 442, 443, in dealing with a situation very similar to this one, ruled as follows:

"* * * As to the Corporation, it is true that it owes the stockholder no duty of disclosure when he trades with others in its stock, and since he has access to the corporate books diligence might well lead him to them when he desires information from the Corporation. But if a corporation (which ordinarily does not deal in its own stock) for its own lawful purposes sets out to buy shares through its managing officers, and they by intentional misrepresentation and concealment deceive a selling stockholder who is ignorant of the truth, though he be an inactive director who ought to know, so that he is damaged, *we see no reason why the corporation is not bound for the consequences. The deceit practiced by the corporation's high officers in the corporation's business and for its benefit must be taken to be a corporate act, and not ultra vires.* 19 C.J.S., §1278 (a) (b); 13 Am. Jur., Corporations, § 1125. ****" (Emphasis supplied.)

The Louisiana Supreme Court, in *American Guaranty Company v. Sunset Realty & Planting Company, supra*, held (23 So. 2d 451):

"An innocent principal cannot be exonerated from the fraud of his agent acting within the scope of his employment. Henderson et al. v. Western Marine & Fire Insurance Co., 10 Rob. 164, 43 Am. Dec. 176.

"*Where an agent acts beyond the scope of his authority but the principal accepts and insists on retaining the benefits and advantages of the fraudulent transaction, this constitutes a ratification.* The Federal Court in Great American Indemnity Co. v. First National Bank, 10 Cir., 100 F. 2d 763, 765, in discussing the foregoing subject, stated:

"'In such a case the principal is impaled on the horns of a dilema.' If he disclaims the gents's act as unauthorized, he has no grounds to retain the fruits thereof; on the other hand, if he retains the fruits of the agent's act, after knowledge of the facts, he must in fairness be charged with the agent's knowledge. Maryland Casualty Co. v. Queenan, 10 Cir., 89 F. 2d 155, 156, 157.'" (Emphasis supplied.)

We must hold, accordingly, that this defense is without merit and must be rejected.(12)

Defendant further specially contends that the representations made by its officers to plaintiffs, that there were no present or future plans for sale or liquidation of its assets, were merely promissory and, therefore, unenforceable, being nothing more than an expression of future intent. Considering the facts we have found, this contention is so clearly unmeritorious as not to warrant discussion, the complete answer being found in the following quotations of authority:

23 American Jurisprudence 798, *et seq.*, verbo "Fraud and Deceit", §§ 37, 38, 41:

"* * * According to the weight of authority, if the person making the statement as to a future event is guilty of an actual fraudulent intent, and makes the misrepresentation with the intention of deceiv-

(12) To the same effect as the quoted authorities are 19 C.J.S. 955, *et seq.*, verbo "Corporations", § 1278; *Standard Oil Co. of Kentucky v. Gunn* (S. Ct. Ala.) 176 So. 332; *Woodruff v. Bates* (S. Ct. Miss.) 50 So. 2d 559; *Koontz v. Sharon, et al.* (S. Ct. Mont.) 94 Pac. 2d 668; *State v. American Insurance Company* (S. Ct. Mo.) 200 S. W. 2d 1, 41; *Sawyer v. Mid-Continent Petroleum Corporation*, 10 Cir., 236 F. 2d 518, 520.

ing and defrauding the other party, and accomplishes this result, to the latter's injury, fraud, may under many circumstances, be predicated thereon, notwithstanding the future nature of the representation. This result is reached frequently on the theory that a person's intention or belief is a matter of fact and that, therefore, if a misrepresentation is made with regard to the same, the misrepresentation is one of fact. False representations as to future events will constitute fraud, where these events depend upon the acts of the party making the representations and form the inducement whereby the other party is led into the transaction, or where the speaker knows that his hearer understands him to mean that facts within his knowledge warrant the expectations he is raising. * * *

* * *

"Where a promisor has no intention of performing his promise when it is made, in the view taken by a majority of courts, a fraud has been committed by deliberate deception and false pretense. Such cases rest upon an entirely different basis for the predication of fraud from that which would be possible in cases of promises honestly made, but subsequently unfulfilled.

* * *

"The weight of authority holds that if the falsity of the statement can be established, a misrepresentation of intent is an actionable representation of fact. A statement by a speaker as to what he intends to do may import a statement of fact, that is, as to his present intention; and if his expressed intention is merely feigned in order to mislead, a charge of fraud may be predicated thereon. It has been stated that *to profess an intent to do or not to do where the speaker intends the contrary is as clear a case of misrepresentation and of fraud as can be made.*

* * *

"Fraud may, in a majority of jurisdictions, be predicated on the nonperformance of a promise in certain cases where the promise is the device to accomplish the fraud, the most frequent example of such

a fraudulent promise being a promise made without any intention of performing it at the time of making it, or where a relation of trust and confidence exists between the parties.

* * *

"If a promise is accompanied with statements of existing facts which show the ability of the promisor to perform his promise, without which the promise would not be accepted or acted upon, such statements are dominated representations and, if falsely made, are grounds of avoiding the contract, although the thing promised to be done lies wholly in the future. It has been said that where a promise is inseparably linked with a misrepresentation of an existing fact, the breach may be the subject of a claim, and that even if reliance is placed upon the mere promises of the defendant, as well as upon his false representations, nevertheless a cause of action for fraud may be maintained provided the representations have had a material effect in accomplishing the deception, since it is not necessary that they shall have been the sole inducing cause. * * *" (Emphasis supplied.)

37 C. J. S. 234, *et seq.*, verbo "Fraud", § 11:

"*Limitations and qualifications of rule.* In the application of the general rule that fraud cannot ordinarily be predicated on unfulfilled promises or statements as to future events, exceptions or limitations have arisen; it is not the rule that all false representations as to future events, or all unperformed promises, are nonactionable. The rule as to a promise made with the intention of not performing it is considered infra § 12. *The fact that statements relate to the future will not preclude liability for fraud if such statements were intended and accepted as representations of fact and involved a matter peculiarly within the speaker's knowledge*, or as to which he professed to have special knowledge, or *if artifice was used to prevent the hearer from learning the truth; nor will redress be refused if the promises or predictions also involve, or are coupled with, a misstatement or con-*

*cealment of existing facts, as where the prediction or promise necessarily includes a misstatement of the existing facts on which it is based, * * *."*

* * *

"Where a relation of trust and confidence exists between two parties, so that one of them places peculiar reliance in the other's trustworthiness, the latter is liable for representations as to future conduct, and not merely as to past facts.

"*A future promise may be fraudulent when it is part of a general scheme or plan, existing at the time, to induce a person to act, as he otherwise would not, to his injury.*" (Emphasis supplied.)

This defense, therefore, must be rejected.

We next consider defendant's contention that all plaintiffs are guilty of laches — in waiting too long to bring this action after they learned that defendant would be liquidated. Max Brown learned of it on July 2, 1955, in a telephone call from Bud Johnson. The other plaintiffs first discovered that the timberlands would be sold in late July or early August, 1955, when stories to that effect appeared in the newspapers. Neither the news stories, nor the call from Johnson to Brown, informed plaintiffs as to the price defendant would receive for the timberlands, and it was months later before plaintiffs found out what prices the other assets would bring. It was not until the stockholders' meeting on September 26, 1955, that plaintiffs learned of the approximate price to be paid by Gair for the timberlands. Three days later, on September 29, 1955, defendant executed its contract of sale to Gair, which was consummated by the actual sale on May 25, 1956.

Meanwhile, on July 9, 1955, one week after receiving the telephone call from Johnson, Max Brown came to Shreveport, bringing his check for $22,750 payable to defendant, the amount he had been paid for his stock, and requested that he be permitted to "come back into

the company". In August, Allen Harrel wrote Johnson the letter quoted above, approximately to the same effect. Both of these requests were summarily rejected by defendant, for the ridiculous reasons we have shown.

Some time in August, Mrs. Hattie Johnson, Mrs. Jennette and the Harrels consulted Whitfield Jack, an attorney in Shreveport, who conferred with C. L. Brooke about the matter. Of course, Brooke did not disclose to Mr. Jack the highly important information he had in his possession, such as his having written defendant the tax letters on August 29 and October 14, 1952, his instructions to assume therein that defendant's assets were worth in excess of $9,000,000, etc.; but it is equally certain that Brooke told defendant's officers about Jack's inquiries, and probably then delivered Jack's letter of September 9, 1952, to them.

On the basis of the meager information then at hand, Mr. Jack advised his clients that, notwithstanding "the dirty aspects" of the case, he could not do anything for them until more facts were developed, recommending that detectives be hired in an effort to uncover them. In late December of 1955, or early January of 1956, plaintiffs contacted Mr. J. Will Patton, Jr., an attorney at Lewisville, Arkansas, who in turn associated plaintiffs' present Shreveport counsel, after first obtaining a release from Mr. Jack. Intensive investigation was begun which ultimately turned up many of the facts shown in this record, many others being developed, however, through discovery proceedings conducted after suit was filed on June 22, 1956; less than one month following the sale to Gair, who paid off the balance due on the purchase price shortly after May 25. Defendant almost immediately distributed the proceeds to its remaining shareholders, so that only $1,300,000 remained in its hands when the suit was filed, and further distribution was halted by our restraining order.

Defendant's counsel argue that plaintiffs should have filed suit before the stockholders' meeting on September 26, 1955, and thus have prevented defendant from changing its position. Having practiced law for about twenty years prior to appointment to the Bench, and considering the nature of the case, we know that it would have been virtually impossible for plaintiffs to have developed sufficient corroborating facts, in support of their own testimony, to have justified them, as responsible people, in filing this suit within the short period intervening between the time they obtained their first knowledge of the proposed liquidation and the date of the stockholders' meeting. Moreover, as noted, it was not until this meeting that they learned of the price to be paid for the timberlands, and since the sales contract was executed only three days later, plaintiffs still had not had time to marshal their facts. By then the die had been cast for liquidation and all that remained to be done was for defendant to convey title to the lands, as it did after Gair's attorneys had approved it.

Plaintiffs' counsel, as responsible, ethical members of the Bar, surely could not have been expected to file a suit based on fraud before they had obtained sufficient evidence in corroboration of their clients' version of the facts. This took time, but not too much time at that, for they had uncovered enough facts to justify their action herein, and filed the suit, within less than a year from the first notice plaintiffs received as to their having been defrauded.

On the basis of these facts, let us examine the applicable rules of equity. 19 American Jurisprudence 338-353, verbo "Equity", §§ 489-509, in a discussion of the doctrine of "Laches", lays down the following pertinent rules:

> "Suit to enforce an equitable claim or cause of action may be held to be barred by the complainant's laches or procrastination in the assertion of his right or

equity, *where the institution of suit has been delayed during a 'unreasonable' period of time.* It is said that 'reasonable diligence' is essential to call into action the powers of a court of equity.

* * *

"The basis of the doctrine of laches is said to be public policy which requires, for the peace of society, the discouragement of *stale* demands.

* * *

"The concept imported by the term 'laches' is fundamental to the notion of responsibility in general; and it finds expression in a variety of other words, one very commonly used being 'negligence.' It is said that 'laches is negligence or omission seasonably to assert a right.' The idea is embodied also in the words 'acquiescence,' 'election,' 'estoppel,' 'abandonment,' 'ratification,' and 'waiver.'

* * *

"While a Federal court sitting in equity is not bound by the state statute of limitations, it will be guided thereby, ordinarily, in determining the question as to whether the suit should be dismissed because of laches.

* * *

"A suit is held to be barred on the ground of laches or stale demand where *and only where* the following facts are disclosed: (1) Conduct on the part of the defendant, or of one under whom he claims, giving rise to the situation of which complaint is made and for which the complaintant seeks a remedy, as, for example, an invasion by the defendant of the complainant's right, such as the right to the possession of property; (2) delay in asserting the complainant's rights, the complainant having had knowledge or notice of the defendant's conduct and having been afforded an opportunity to institute a suit; (3) *lack of knowledge or notice on the part of the defendant that the complainant would assert the right on which he bases his suit; and* (4) *injury or prejudice to the defendant in the event relief is accorded to the complainant or the suit is not held to be barred.*

"The adjudicated cases 'proceeded on the assumption that the party to whom laches is imputed has knowledge of his rights, and an ample opportunity to establish them in the proper forum; that *by reason of his delay the adverse party has good reason to believe that the alleged rights are worthless, or have been abandoned; and that, because of the change in condition of relations during this period of delay, it would be an injustice to the latter to permit him now to assert them.*'

* * *

"The question as to whether the elements of laches have been established in any particular case is, of course, one of fact and calls for the exercise of a sound discretion by the trial court.

* * *

"* * * The fact that the complainant has delayed to bring suit will *not alone* be held to have barred him of relief. While laches is often spoken of as the equitable equivalent of the legal statute of limitations, yet there is no fixed time which makes it an absolute bar. The period establishing laches is not 'one which can be measured out in days and months as though it were a statute of limitations.' The determination of the question as to laches vel non proceeds in the light of the circumstances of the case. *What might be inexcusable delay in one case would not be inconsistent with diligence in another.*

* * *

"The third of the constituents of laches is injury or prejudice to the defendant in the event relief is granted to the complainant. A correct statement is that *the doctrine of stale demand applies only where, because of lapse of time, 'it would be inequitable to allow a party to enforce his legal rights.'*

* * *

"*If prejudice will not be occasioned to the defendant as a result of the assertion of the complainant's right, laches is not predicable of delay attending the commencement of the suit.* * * *" (Emphasis supplied.)

The Fifth Circuit Court of Appeals, in accordance with the rules just quoted, has held, in *United States v. Alex Dussel Iron Works*, 31 F. 2d 535:

> "* * * Laches consists of two elements, *inexcusable delay* in instituting suit *and prejudice* resulting to the defendant from such delay. Its existence depends upon the equities of the case, and not merely upon the lapse of time. * * * Differing from prescription, *time alone is not enough to show laches. The circumstances and the equities of the parties must be as well considered.* The Key City, 14 Wall. 653, 20 L. Ed. 896. * * *" (Emphasis supplied.)

The Supreme Court of Louisiana, in *Labarre v. Rateau*, 210 La. 34, 26 So. 2d 279, puts it this way:

> "The doctrine of laches, equitable in character and fully discussed in 30 C.J.S., verbo Equity, §112 et seq., 'is based on the injustice that might result from the enforcement of long neglected rights, the difficulty, if not the impossibility, of ascertaining the truth of the matters in controversy and doing justice between the parties, and on grounds of public policy, its aim being the discouragement, for the peace and repose of society, of *stale and antiquated demands.*' 30 C.J.S., Equity, § 113. *What constitutes laches is to be determined in the light of the circumstances of the particular case.* The doctrine's application is controlled by equitable considerations: *it cannot be invoked to defeat justice; it will be applied only where the enforcement of the right asserted would work injustice.* 30 C.J.S., § 115. *While delay in enforcing a right is an element of laches, such delay does not of itself constitute* laches. * * *" (Emphasis supplied.)

Applying these principles to the facts detailed, it is perfectly clear to us that plaintiffs have not been guilty of laches so as equitably to bar their right of recovery here. They did not delay taking action for an "unreasonable" time. Defendant had notice well before the stockholders' meeting of September 26, 1955, that plaintiffs were contending they had been defrauded and

intended to do something about it, some of them even having employed an attorney to assert their rights. By no means could defendant have concluded that plaintiffs' claims were being "abandoned", so as to lull it into a false sense of security. On the contrary, it is most apparent that the officers knew plaintiffs were outraged by their conduct and that they, the officers, were almost literally racing to close the deal with Gair at the earliest possible time.

Moreover, defendant has not been "prejudiced" in any sense by the suit not having been filed sooner. As we have stated in this record before, in passing upon preliminary motions, true it may have been that defendant changed its position after plaintiffs became aware that it would be liquidated. Yet, its change of position — the very thing that plaintiffs complain about — resulted in no disadvantage to the corporation itself, which, according to plan, would have transferred all of its property and have been dissolved, had it not been brought to a halt by this lawsuit. The change, rather, was intended to be, and actually was, to the considerable advantage of the majority shareholders, and to the substantial disadvantage, and at the expense of these plaintiffs. That, verily, is what this suit is all about.

For these reasons, we find the plea of laches to be totally without merit[13] and it is rejected.

(13 We also are strongly impelled to this view by the fact that the suit was filed well within the one-year period of limitations — prescription — provided for by Louisiana law, in L. S. A. - Civil Code Articles 3536 and 3537, for the enforcement of actions based on fraud. *Thompson v. Whittington*, 127 La. 551, 53 So. 860; *Lutz v. Forbes*, 13 La. Ann. 609. This one-year period dates from the discovery of the fraud. See *Reardon v. Dickinson*, 156 La. 556, 100 So. 715, 717:

> "The plea of prescription is manifestly untenable under the facts of this case. The petition alleges and the evidence establishes that the plaintiffs did not discover that a fraud had been practiced on them until May, 1920, and the suit was filed in less than a year thereafter. As a

Defendant argues that Mrs. Hattie Johnson and Mrs. Jeanette Jennette have ratified and condoned its fraud, committed in the purchase of their stock, and are estopped now to attack the transaction and rescind the purchase contracts, by having accepted payments from defendant after learning of the fraud in late July or early August, 1955.

When they sold their stock to defendant on November 14, 1953, they were paid about one-third of the purchase price in cash, and for the balance were given defendant's installment notes, payable serially on November 1st and May 1st of each year, secured by a mortgage on approximately 11,000 acres of defendant's lands. The notes held by Mrs. Jennette extended over a period of ten years, and those held by Mrs. Johnson were for fifteen years. They contained a call privilege whereby, on thirty day's notice, and upon paying 2% on the principal balance due, defendant could retire them in advance of their maturities.

These notes were kept in their lock boxes at the Fairfield Avenue Branch of the Commercial National Bank in Shreveport. As they fell due, defendant would make payment at the bank, which in turn would notify the payees that this had been done. They would go to the bank, take all the notes from the lock boxes, present them at the Note Teller's window, receive payments of principal and interest due, and surrender the maturing notes for cancellation, with interest payments being credited upon the remaining notes, not yet due.

13—CONTINUED

matter of fact, while the false representations were made and the stock was issued to the plaintiffs more than a year before the suit was filed, the actual loss and damage only occurred within the year preceding the filing of the suit."

See also *Amen v. Black*, 10 Cir., 234 F. 2d 12, 15, and authorities therein cited.

Each of them surrendered, and was paid for, serial installment notes falling due on November 1, 1955, and May 1, 1956. On May 25, 1956, they were notified that all remaining notes would be called and paid at once, whereupon they required defendant to give the thirty-day call-notice, thereafter being paid on June 25, 1956, after first delivering to the bank, for transmission to defendant, a letter notifying defendant that they would insist upon their rights in this suit, which were not being waived or surrendered in any way.

When the payments of November 1, 1955, and May 1, 1956, were received and accepted, neither Mrs. Johnson nor Mrs. Jennette had consulted counsel about them, although in November they were represented by Whitfield Jack, and in May by present counsel, who wrote the letter to defendant for them to sign and deliver to the bank, before acceptance of the payments made on June 25.

There is not the sligtest evidence in this record, other than the bare acts of receiving payments as outlined, which would indicate that these ladies had any intention of surrendering their rights or of ratifying or condoning the fraud committed by defendant's officers in acquiring their stock. On the contrary, defendant knew full well that they had employed counsel, and that a lawsuit attacking the stock purchase probably could be expected at almost any time. Defendant was not injured in any way by what was done and did not change its position because of this. In the accounting which will be ordered, it will be entitled to receive credit against its indebtedness to these ladies, for the full amounts they have received.

In Louisiana,[14] and elsewhere,[15] the universal rule is that in order for there to be a ratification or

(14) *International Accountants Society v. Santana*, 166 La. 671, 117 So. 769, 770:

"* * * *To execute voluntarily is to execute with the intention to confirm and ratify.* Celeste Sugar Co. v. Dunbar-Dukate Co., 160 La. 694, 107 So. 493; Augustin v.

an estoppel, by conduct such as this, the burden of proof rests upon the one claiming ratification to show, by clear,

14—CONTINUED

Farnsworth, 155 La. 1053, 99 So. 868; Sims v. Jeter, 129 La. 262, 55 So. 877. *In either case the intention to ratify by the party against whom the act is opposed must be clearly and unequivocably shown.* Celeste Sugar Co. v. Dunbar-Dukate Co., supra; Wells v. Files, 136 La. at page 133, 66 So. 719; Sims v. Jeter, supra; Breaux v. Carvoie, 39 La. Ann. 243, 1 So. 614. *No intention to ratify will be inferred when the act can be otherwise explained.* Sims v. Jeter, supra. *And in case of doubt the party against whom ratification or voluntary execution is claimed must have the benefit of the doubt.* Succession of Easum, 49 La. Ann. 1345, 22 So. 364.

"The burden of proving the ratification or voluntary execution of the contract is on the plaintiff. Riva's Heirs v Barnard, 13 La. 175. * * *" (Emphasis supplied.)

Selber Bros. v. Newstadt's Shoe Stores, 203 La. 316, 14 So. 2d 10, 13, 14:

"Estoppel, as a general rule, is effective only when it appears that the person pleading it has been misled *to his injury* by acts of omission or commission of him who is sought to be estopped; and it is not favored in law and should not be maintained except in clear cases. Louisiana Oil Refining Corporation v. Williams et al., 170 La. 218, 127 So. 606; Tyler v. Walt et al., 184 La. 659, 167 So. 182; Succession of Butterworth, 195 La. 115, 196 So. 39.

"In the instant case, the cashing of the checks, representing the minimum rental for the mentioned four months' period, was in no manner misleading and prejudicial to defendant. There was nothing to prompt a belief by the latter that the rent dispute had been terminated and to cause it to assume a position inimical to its best interests. *To the contrary, defendant was repeatedly informed and knew all along that plaintiff was claiming rental in addition to the minimum payments.*

"But defendant urges, under the discussed special plea, that the acceptance of the minimum amounts resulted in what is termed an accord and satisfaction and that plaintiff is now estopped to collect the excess rental. In support of that position it cites and relies on Meyer v. Acme Homestead Association, 18 La. App. 697, 138 So. 443; and Berger v. Quintero, 170 La. 37, 38, 127 So. 356. In each of those cases, as we appreciate the facts thereof, there accompanies the delivered check a written declaration of the obligor that the payment constituted

convincing and unequivocal evidence, that, with full knowledge of *all* the facts, there was an *intention to ratify*

(14)—CONTINUED

full settlement of the balance of the indebtedness, thus implying that its acceptance would entirely discharge the obligation; and the court held that by accepting the check the creditor was estopped to recover more.

"In the controversy now before us, it does not appear that the payments were tendered upon a condition, expressed or implied, that the indebtedness would be fully satisfied if they were accepted.

* * *

"Under the circumstances shown above, plaintiff, we think, is not estopped by its described actions. * * *" (Emphasis supplied.)

See also, to the same effect, *Emerson v. Shirley*, 191 La. 741, 186 So. 88; *Louis Breaux v. Estival Sarvoie, et als.*, 39 La. Ann. 243, 1 So. 614,

(15) 24 American Jurisprudence 34, *et seq.*, verbo "Fraud and Deceit", §§ 209, 210:

"* * * *To invoke the rule of waiver, however, it has been held to be essential to show that the defrauded party intentionally condoned the fraud, affirmed the contract, and abandoned all right to recover damages for the fraud, with full knowledge thereof. The affirmance must be equivalent to ratification.* The question of outright waiver is one of intent; and it is essential to such waiver that the victim posses full knowledge of the fraud practiced upon him and that he *intend to affirm the contract and abandon his right to recover damages for the loss resulting from the fraud.*

* * *

"Equivocal acts which do not clearly evince a purpose, with complete knowledge of the fraud, to retain the property as his own will not defeat the right of a person defrauded to rescind. The act must be unequivocal and must show an election to retain the property after discovering the deceit before the right to rescind is gone. *Where subsequent acts are relied upon as a defense in a case where fraud is clearly established, it is said the acts must stand upon the clearest evidence, must evince a purpose to waive or forgive the fraud, and must amount to a clear election not to rescind. If what is done is merely for the purpose of saving the plaintiff from further loss, without any purpose to give up whatever right he may have either at law or in equity to rescind, the right of rescission will not be affected.* * * *" (Emphasis supplied.)

See also, to the same effect, *Commercial National Bank v. Parsons*, 5 Cir., 144 F. 2d 231.

and to surrender their rights, on the strength of which defendant has ruled and acted to its detriment.

The Fifth Circuit Court of Appeals, in *Union Producing Company v. Pardue*, 117 F. 2d 225, 227, rejected a plea of estoppel and ratification where gas royalty payments were received by the plaintiff from defendant in amounts less than plaintiff was claiming were due, and there was no showing that defendant had been misled:

> "* * * It was the duty of appellant and its predecessors under the leases in question, to pay appellee each month for the gas it had bought from him in the previous month. The performance of this duty and the receipt by appellee of the check, could not of itself raise an estoppel against appellee, constitute a settlement, or be the basis of any claim of accord and satisfaction. Nor would the fact that appellant was dissatisfied with the price and grumbled about it, at all change the situation. *In order for there to have been an estoppel, appellee must have acted in such a way as to mislead appellant to its detriment, whereas all that appellee did here was to receive the moneys appellant felt bound to tender. In order for there to have an accord and satisfaction or a settlement for less than was appellee's due, there must have been a real dispute and the dispute must have gone to the point of a recognized active controversy and a settlement of that controversy on terms understood and accepted by the parties to it as such a settlement.* * *" (Emphasis supplied.)

Defendant further claims that, since Mrs. Johnson and Mrs. Jennette attended the stockholders' meeting held on September 15, 1953, and voted to ratify the purchases of minority stock previously made by defendant's officers, and for a reasolution authorizing the Board of Directors to purchase their stock, they thereby ratified all that was done, and are estopped to maintain their present position. It is our conclusion, however, based upon the authorities cited above, that they did not thereby ratify defendant's previous fraud, or that about to be committed upon them.

of which they were ignorant, nor are they estopped now to assert it.

We conclude, therefore, that since defendant was not misled by anything done or omitted by Mrs. Johnson and Mrs. Jennette, nor was is injured in any way, and since it is entirely clear that these ladies neither actually nor impliedly intended to ratify or condone the fraud that was committed upon them, this defense is without merit and must be rejected.

Max Brown is in a somewhat different position than the other plaintiffs, in that he knew defendant's stock was worth at least $2,000 per share, on a liquidation basis, when he sold his stock to the company.

The circumstances were that he was employed as manager of defendant's Zwolle mill at an annual salary of $15,000. He owned 65 shares of stock. During the summer of 1953, he was instructed by defendant's President to come to the General Office at Shreveport, where he saw his cousin, Brown McCullough. No effort was made to negotiate with him to sell or to fix a price for his stock. He simply was told that the President of the company wanted him to "turn in" his stock for $350 per share. At that time he told McCullough it was worth more than $2,000 per share on a liquidation basis, but was assured that there were no plans for liquidation, present or future. Because he did not want to risk losing his job, and having been promised that there would be no liquidation, he readily agreed to, and did, sell his stock for $350 per share.

Shortly thereafter, McCullough transferred one share of stock to Max Brown on the company's books, but simultaneously had him endorse it back to the company. The purpose of this was to qualify Brown to serve as a director, which he did until the company's assets were sold. He attended the annual shareholders' and directors' meetings held in September of 1953, 1954 and

1955. Among other actions in that capacity, he voted at the stockholders' meeting in September, 1953, to ratify the purchase by the officers of the minority stock, including his own; and at the special shareholders' meeting held on September 26, 1955, he also voted in favor of the plan of liquidation then submitted, although he previously had requested to "come back into the company", on July 9, 1955. When the company's assets were sold in 1956, he was given one year's salary as severance pay, similar amounts having been paid to other long-time employees at that time.

Defendant argues that there was no fraud committed against Max Brown, and that, in any event, he has ratified what was done, so as to estop him from recovery in this suit.

It is our opinion that fraud was committed upon Max Brown in that he would not have sold his stock had it not been for false promise, made to him by his cousin, that defendant would not be liquidated. It also is our view that he was forced to act under heavy duress, not only in selling his stock but at all times until his job was terminated in 1956. Before he sold, he held relatively few shares of a stock with a rather poor dividend record. His salary with defendant, as a going concern, thereby was made to appear to be of far greater importance than the price of the stock. He wanted to continue earning that salary. There was a strong likelihood that he would be fired if he opposed the wishes of defendant's President, who had absolute power to terminate his job at any time.

Brown was the victim, therefore, of both fraud and business duress. He knew the liquidation value of his stock, but did not know that serious plans to liquidate defendant already were afoot, contrary to what his cousin had assured him. He did not want to be fired, so he sold, with full reliance upon McCullough's promises. He likewise was under duress at the stockholders' meetings in 1953 and 1955. At the first meeting, he did not know

that fraud had been and would be committed. At the second, when he voted the one share standing in his name in favor of liquidation, he knew he actually did not own that share, and, in any event, he hoped to continue working for a good salary as long as possible, with some hope of severance pay. Consequently, rather than raise an ineffective ruckus, and knowing that the majority had more votes than it needed to decree liquidation, he "went along" by voting for liquidation.

Nothing Max Brown did in this respect misled defendant to its detriment in any way, and, by the same token, what he did was not a free and voluntary ratification, especially since the full tenor of defendant's fraud was not then ascertainable or apparent, being more a matter of strong suspicion than provable fact.

While Max Brown's case is not as strong as that of the other plaintiffs, on the basis of the authorities cited above, and also upon *Dale v. Simon*, 267 S. W. 467, 79 A. L. R. 659; *New Orleans & Northeastern Ry. Company v. Louisiana Construction and Improvement Company*, 109 La. 13, 22, 33 So. 51; *Sistrom v. Anderson*, 124 Pac. 2d 372, 376, 51 Cal. App. 2d 213; *Starks v. Field*, 89 Pac. 2d 513, 515, 198 Wash. 593; *Voellmeck v. Harding*, 6 Pac. 2d 373; 17A American Jurisprudence 564, *et seq.*, verbo "Duress and Undue Influence", §§ 7, 26; *Commercial National Bank in Shreveport v. Parsons*, *supra*, we must find that the defense of ratification by Max Brown is unmeritorious and must be rejected.

Defendant has made a large number of additional points of defense, mostly collateral or incidental to those we have discussed. It also has cited many cases and textual authorities, not mentioned herein. We have carefully considered all of these, but have found that the defenses are without merit and the authorities relied on are distinguishable because of the facts here found. It would unduly lengthen this necessarily extensive opinion expressly to discuss them here.

In conclusion, we must note for the record our sincere regret at having been forced to find that defendant's officers were guilty of fraud. We have done this reluctantly, and only because the proof is so clear. To have overlooked it, or to have characterized their actions in any other light, not only would be less than candid, but would be a violation of our sworn duty.

For reasons given, therefore, a decree will be entered herein, ordering rescission of the sales of plaintiffs' stock to defendant, as made in 1953, and recognizing plaintiffs as its equitable owners. Defendant will be required to make a full, accurate accounting upon terms to be settled.

A proper decree should be presented for signature.

THUS DONE AND SIGNED, in Chambers, in Shreveport, Louisiana, this the 24th day of January, 1958.

s BEN C. DAWKINS, JR.
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

CIVIL ACTION

NO. 5562

HATTIE A. JOHNSON, ET AL.

vs.

MANSFIELD HARDWOOD LUMBER COMPANY

BEN C. DAWKINS, JR., CHIEF JUDGE.

RULING ON MOTION FOR NEW TRIAL OR REHEARING

We have given careful consideration to the points made in this motion, and have studied the respective briefs and authorities cited, having reached the following conclusions:

1.

When, during the trial, while the case was with defendant and well before the evidence was closed, it became perfectly clear that the integrity of the operation known as Shreveport Lumber Sales was seriously in question, it then became the duty of defendant's officers to bring forth all of the facts for the Court to judge.

Instead of making a full disclosure, supported by books and records, defendant was content to rely upon an inadequate verbal "explanation", given by its officers. They seemed reluctant to discuss the extent of the operation, even in response to questions by the Court, just as they also were most reticent about their salaries and expense allowances, which they never fully disclosed or documented by books and records.

Since they had admitted that the 5% "commission" had been collected on 100% of defendant's sales during OPA days, and since price controls were again in force, under OPS, from the early days of the Korean War, which began in June 1950, we naturally concluded that the same practice had been followed then.

Now, in support of its present motion, defendant has filed documents which purport to show that the "commission" was charged against only about 10% of defendant's sales, i. e., that the annual "take" by defendant's officers and their families, during 1950-53, averaged about $14,500, instead of the higher figure we had calculated. The documents make no effort to show how much had been realized in this fashion during prior years, as to which we can only wonder.

We must regretfully conclude that the difference is merely one of degree, not principle. Moreover, this feature of the case was important only insofar as it corroborated our conclusion, on consideration of all evidence, that defendant's officers were guilty of overreaching. The additional "evidence" submitted by defendant in support of this motion not only does not refute this conclusion, it actually reconfirms it, even if to a lesser degree.

In any event, on the strength of the evidence otherwise conclusively proving plaintiffs' right to prevail, as set forth in our original opinion, we would have decided the case as we did even if there had been no evidence submitted regarding Shreveport Lumber Sales.

Shortly restated, the simple, central facts were that all plaintiffs, except Max Brown, were pressured into selling their stock by the unconscionable "dividend squeeze", applied by defendant's officers, and their false promises that there would be no liquidation. In such circumstances, we think equity demands the decision we have rendered, on which we must resolutely stand.

2.

Defendant's motion also would show that Max Brown was permitted to share in the "commissions" to the extent of about $150 per month, during 1950-53. To that extent, but only that, were we in error in stating that the "minority" did not know about this operation; for none of the other plaintiffs knew of it, nor did they share in it. This does not alter Max Brown's right of recovery in the case for, instead of having been subjected to the "dividend squeeze" which was applied to the other plaintiffs, and which so strongly motivated them in selling their stock, he virtually was ordered to turn his in to the company. He sold it because 1) he wanted to retain his fairly lucrative job with defendant, with any direct or incidental emoluments, and 2) he relied on his cousin's promise that defendant would not be liquidated. While, as we have stated, his position in the case is not nearly as strong as that of the other plaintiffs, we still think he should prevail because there is no question but that he was defrauded, to the extent of more than $100,000.

3.

The remaining thirty points, as to which defendant contends we committed error, have been through the wringer time and again in the past, both here and to some extent in the appellate Court.

In passing, jocularly, we cannot help noting that we must be mellowing with age to have erred a total of only 33 times in this opinion, as against defendant's claims of 106 errors in our former opinion, on the injunctive feature of the case.

Seriously, we see no useful purpose to be served by replowing old ground, which already has been fully

surveyed and thoroughly dealt with in our opinion on the merits.

For the reasons given, the motion for a new trial or rehearing i DENIED.

THUS DONE AND SIGNED, in Chambers, at Shreveport, Louisiana, on this the 2nd day of April, 1958.

s Ben C. Dawkins, Jr.
UNITED STATES DISTRICT JUDGE

JUDGMENT

DISTRICT COURT OF THE UNITED STATES
WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

* * * * * * * * * * * * * * * * * * *

CIVIL ACTION No. 5562

HATTIE A. JOHNSON, ET AL.

vs.

MANSFIELD HARDWOOD LUMBER COMPANY

* * * * * * * * * * * * * * * * * * *

This case having come on regularly for trial before the Court sitting without a jury, the Court being fully advised in the premises and having filed herein its "Findings Of Facts And Conclusions Of Law" and having directed that judgment be entered in accordance therewith, now, therefore, by reason of the law and findings aforesaid;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED,

1. That the following sales of stock to defendant be and the same are hereby vacated, set aside, annulled and declared of no effect:

Sales By	*No. of Shares*
Hattie A. Johnson	547
Jeanette Johnson Jennette	667
Mamie E. Harrell (Plaintiff herein, Cora Harrel, Administratrix of the estate of Mamie E. Harrel, deceased)	131
J. A. Harrel	43
Elizabeth Harrel Walker	30
Ruth Harrel Mulkey	22
Max Brown	65
Alice S. H. Brown	10
Minnette Velvin (Plaintiff herein, Drew Velvin, Executor of the estate of Minnette Velvin, deceased)	51

2. That the individual plaintiffs have judgment against defendant for their pro rata portion of the assets of defendant distributed in liquidation, said portions to be credited with the amount each plaintiff received for his stock.

3. That defendant file with the Clerk of this Court in the record of this suit within 90 days its sworn statement setting forth in both summary form and in reasonable detail: a description of its assets as of September 26, 1955 (the date liquidation was voted); its income subsequent thereto; the dispositions made of both; the dates on which such dispositions were made; a statement of its stock ownership as of September 26, 1955, including plaintiffs; and its calculation of the dollars and properties which would have been due each such share of stock in liquidation.

4. That when the ordered accounting is made and approved, then this Court will determine the monies and properties due each plaintiff and will enter judgment therefor including interest and costs.

5. That the preliminary injunction entered herein on September 19, 1956, be and the same is hereby made permanent without bond; the Court appointed Trustee, Commercial National Bank in Shreveport, is to continue to hold the assets received by it pursuant to said preliminary injunction according to the terms and conditions set out in said preliminary injunction and until further order of this Court.

6. The bonds heretofore filed by plaintiffs as a condition to the issuance of the temporary restraining

orders and preliminary injunction are cancelled and the sureties are discharged and relieved of all liability under said bonds.

THUS DONE AND SIGNED in Shreveport, Louisiana, this 4th day of April, 1958.

s BEN C. DAWKINS, JR.
UNITED STATES DISTRICT JUDGE

Filed April 4, 1958.

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 17299

MANSFIELD HARDWOOD LUMBER COMPANY,

Appellant,

versus

HATTIE A. JOHNSON, ET AL.,

Appellee.

Appeal from the United States District Court for the Western District of Louisiana.

(February 20, 1959.)

Before RIVES, TUTTLE, and BROWN, Circuit Judges.

RIVES, Circuit Judge: This appeal is from a final decree ordering a rescission of sales of corporate stock made in 1953, granting plaintiffs a pro rata portion of assets realized by a liquidation of defendant corporation, ordering an accounting by defendant, and making permanent a temporary injunction, already issued.

The opinion and order granting the temporary injunction were reported at 143 F. Supp. 826. This order

was affirmed at 242 F.2d 45. This case was reported on the merits at 159 F.Supp. 104 in a twenty-seven page opinion where District Judge Benjamin C. Dawkins, Jr., preludes:

"The crux of the case is that, had it not been for this suit, the majority—six people who proceeded to sell and liquidate the corporate assets immediately after the minority stock was bought, notwithstanding promises that this would not be done—would have reaped a profit for themselves, before taxes, of more than $3,400,000, at the expense of the minority, and in addition to nearly $6,000,000 rightly to be received by them in the liquidation for their own stock.

"All persons involved are educated, cultured, refined. They have enjoyed, and still occupy, positions of prestige in their home communities. Until this tragic controversy arose, they appeared to be fairly congenial, at least on the surface.

"Now, regrettably, they are publicly and irreconcilably divided into two warring camps. One group—the former minority stockholders—is convinced that its members are victims of deliberate fraud perpetrated upon them by the majority. For their part, the majority resists and resents, with equal fervor, the charges made against them.

"While the suit is one which ought not to have been necessary, and clearly should have been settled, the depth of feeling is such that compromise has not even been discussed. Consequently, this litigation must run its bitter course, for better or for worse.

". . . .

"After a full trial on the merits, lasting more than a week; having heard all of the parties and their

witnesses; having considered the lengthy briefs (totaling approximately 300 pages), and the authorities cited; having studied the transcript of testimony and exhibits (some 1255 pages); having heard the oral arguments of respective counsel, lasting nearly three hours; and having reached our findings of fact and conclusions of law, we now set them down for the record. They represent to us the only result which justly could come from the evidence before us.

"While there are some facts not in dispute, there are many more which are hotly controverted, especially as to what was said or not said, done or not done, known or not known, with regard to the purchase of plaintiffs' stock. In stating the facts we have found, our statements are based upon what we believe to be the truth, notwithstanding some testimony to the contrary. We also have drawn inferences, which we believe to be reasonable and correct, from the facts and circumstances in evidence."

159 F.Supp, at pp. 106, 107-108.

This case concerns the purchase of minority shares from the plaintiffs as treasury stock by the defendant-corporation and a subsequent liquidation of the corporation, the transaction alleged (1) to have been fraudulent upon the interest of the plaintiffs, or (2) to have unjustly enriched the defendant, or (3) to have had no "serious" consideration under Art. 2464 Louisiana Civil Code.[1]

[1] "Art. 2464. The price of the sale . . . ought not to be out of all proportion with the value of the thing; for instance the sale of a plantation for a dollar could not be considered as a fair sale; it would be considered as a donation disguised."

The gist of the complaint is in paragraph 28 thereof, which states:

"28. Plaintiffs aver that A. S. Johnson and Brown McCullough (acting in their capacities as President and Vice President, respectively, of Defendant, and who actually dominated the business policies of the Company and without securing the prior approval of the directors or stockholders of Defendant) conceived a fraudulent scheme acquiesced in by those stockholders whom they controlled and constituting a majority of the outstanding stock, whereby they conspired to cause Mansfield Hardwood Lumber Company to buy as treasury stock all the stock of the remaining stockholders for an inadequate price and then to cause the company to sell its assets and distribute the proceeds upon liquidation at a tremendous profit to the conspiring group. The plan or artifice of the scheme was to cause Mansfield Hardwood Lumber Company to falsely notify the minority stockholders that dividend payments would be virtually discontinued for a period of the next 15 to 20 years, this to be the consequence of the company's entering upon a long range plan of extensive reforestation and improvement of its assets. The company was to negotiate for and purchase the stock at a price approximating its value as reflected by the books of the company, which value the conspirators knew to be grossly understated. The company was to falsely deny any intention of disposing of its assets and liquidating. Plaintiffs aver that the representations made to each of them in the purchase of their stock was in furtherance of this fraudulent scheme."

The intricate facts are set out fully in the opinion below at 159 F.Supp. 104, 106-117, and it would be

redundant for us to reiterate them here. However, for the purpose of this opinion, we must attempt a brief summary.

The sole defendant is a corporation formed in 1901 by two men, the predecessors of the parties in interest here. The corporation engaged in the business of growing timber and sawmilling and by 1955 had acquired extensive holdings—some 93,000 acres of timberlands, two sawmills, several lumber companies, and a small railroad. Out of the 4,836 shares of stock outstanding in 1953 (par value of $100 per share), the defendant's three officers and their immediate families owned some 2,751 shares. These three officers — A. S. (Bud) Johnson, Brown McCullough, and T. W. M. Long — and their families will be referred to as the majority stockholders. The remaining shares were spread out among the plaintiffs and others, the two largest holders being plaintiffs, Mrs. Hattie A. Johnson and Mrs. Jeanette Johnson Jennette. The corporation began purchasing the minority shares in the Spring of 1953 for $350 per share and made its last purchase from Mrs. Johnson and Mrs. Jennette in the Fall of 1953 for $400 per share. The defendant purchased a total of 1,567 shares. There was some evidence that the fair market value of the stock, considering all elements, was about $320 per share.

As early as 1952, the officers of the corporation considered the possibility of liquidating the corporation but testified that this possiblity was dismissed because of the large tax consequences. In the Spring of 1954, some negotiations for a liquidation sale were resumed in earnest; and, after receiving word that Sections 331 (a) (1)

and 337 (a) of the 1954 Internal Revenue Code would become effective on August 16, 1954, which would abolish the double capital gains tax in liquidation, that is on both the corporation and the stockholders, the officers actively solicited a sale to several purchasers. In July 1955, Robert Gair Company, Inc. had agreed to purchase all the assets of defendant, excepting certain mineral rights, for $9,531,630.34. This agreement was approved by defendant's remaining stockholders on September 26, 1955, and the sale to Gair was consummated on May 25, 1956.

As the district court found, had the plaintiffs and other minority sellers not sold their stock, it would have been worth about $2,068 per share on liquidation or over five times the amount received. The majority stockholders thus profited by some $3,458,007 from the treasury purchases.

There are two outstanding facets in this case: (1) the shortness of the time interval between the purchase of the minority shares as treasury stock and the subsequent liquidation of the corporation, and (2) the great difference between the amount paid per share for the repurchased stock ($350 to $400) and its worth on liquidation ($2,068).

Thirty-four specifications of error are assigned by appellant. Some merit consideration and some are purely frivolous. In discussing only those which we think dispositive of the case, we again refer for a more complete statement of the facts to the opinion below.

Great emphasis is placed on the failure to join as indispensable parties the officers as wrongdoers, the

liquidators, the stockholders after adoption of liquidation, the court trustee (a local bank) holding the remaining liquidated assets not yet disbursed, and the stockholders as owners of the assets held by the trustee. To join any of these would, of course, defeat diversity juridiction. On the prior appeal, from the granting of the temporary injunction, Chief Judge Hutcheson stated, for this Court at 242 F.2d 45, 47:

> ". . . . and agreeing with the district judge that the case should not have been dismissed for want of indispensable parties,[1] . . . .
>
> "[1] Hudson v. Newell, 5 Cir., 172 F.2d 848, at page 850, Id., 5 Cir., 174 F.2d 516; Mackintosh v. Marks, 5 Cir., 225 F.2d 211. Cf. Christian v. Texas Gas Co., D.C., 14 F.R.D. 80, 81."

Without deciding whether this prior adjudication of jurisdiction is the law of the case,[2] we note that, under the circumstances of this case, if the plaintiffs have stated a claim against the defendant corporation upon which relief can be granted, the failure to join the corporate officers and others as party-defendants is not fatal, for

> "The power of a court of equity so to mold its decree as to do complete justice between the parties without adversely affecting those not before the court is exceedingly broad and elastic."

Mackintosh v. Mark's Estate, 5th Cir. 1955, 225 F.2d 211, 215.

[2] *See*, Richardson v. Ainsa, 218 U.S. 289; Federal Reserve Bank v. Omaha National Bank, 8th Cir. 1930, 45 F. 2d 511, 514; *cf.*, Lowry v. International Brotherhood, etc., 5th Cir. 1958, 259 F.2d 568, 575.

This brings us to consider whether defendant's motion to dismiss should have been granted for failure to state a claim, which also raises substantially the same question presented in its argument concerning the joinder of defendant's officers as indispensable parties. In defendant's brief, it summarizes:

> "In summary, it is submitted that the Court below erred in failing to dismiss this action because the complaint fails to state a claim upon which relief can be granted in three important respects: (1) the complaint affirmatively alleged that the sale of plaintiffs' stock was induced by the alleged fraud of defendant's officers who are alleged to have acted without authority and for their own benefit; (2) the complaint fails to state the value of the stock in its then condition, at the time of the sale; and (3) the alleged representations by the officers with reference to future dividends and future liquidation of the corporation were mere indefinite expressions of opinion, relating solely to future prospects of the Corporation, and could not, if made, constitute grounds for an action for rescission for fraud."

We feel it unnecessary to dwell upon these contentions because, after carefully studying all of the evidence in this cause, we are of the opinion that the district court was clearly erroneous in finding that fraud per se of defendant through its officers was established beyond a reasonable doubt to the extent of "grasping greed" and "moral bankruptcy." We so hold because of our doubt that the "intent" element necessary as the basis for actual fraud was adequately established. In other words, we doubt that defendant's officers during the stock purchases

from plaintiffs had the necessary *mens rea* for a predication of actionable fraud.

However, the results were correct and are soundly predicated, we think, upon the liability for breach of the fiduciary duty owed by a corporation's officers to its individual stockholders. Practically all jurisdictions recognize a fiduciary relationship arising from the directors and officers to their corporation and to the stockholders as a whole, while a "growing minority" accord this duty to individual stockholders,[4] especially concerning the purchase of stock from a shareholder.[5] Whether this relationship between officers and directors and their stockholders is termed fiduciary or quasi-fiduciary or trust or con-

[4] Belcher v. Booth, 1927, 164 La. 514, 114 So. 116; American Guaranty Co. v. Sunset Realty & Planting Co., 1944, 208 La. 772, 23 So.2d 409, 420.

[4] See Fletcher, Cyclopedia Corporations, perm.ed., §848:

"Sometimes it is said that a director or other managing officer is a trustee in so far as the corporation and its stockholders are concerned, and sometimes it is said that he is a trustee only as to the corporation itself. However, the better rule, although not sustained by the weight of authority, seems to be that he is a trustee for an individual stockholder, as well as the corporation, at least in a limited sense."

[5] "There is a sharp conflict in the authorities over the question as to whether the relations between a director or officer of a corporation, on the one hand, and shareholders on the other, are not of such a fiduciary nature as to make it the duty of the former to disclose the knowledge which he possesses affecting the value of the stock before purchasing the same from a shareholder. To go further back, it would seem that the dividing line is whether directors are to be deemed trustees for individual stockholders so far as their stock in the corporation is concerned." Fletcher, Cyclopedia Corporations, perm.ed., §1168.

"The older or so-called majority rule laid down by one class of decisions is that 'while directors occupy a trust

fidence is immaterial, and, likewise, is it immaterial whether its breach is described as constructve fraud, unjust enrichment, fraudulent breach of trust, breach of fiduciary obligation, gross negligence, or otherwise, and whether the remedy is given by a constructive trust, restitution, or accounting. These are all relative terms describing broad equitable concepts. The standard of a fiduciary's duty to his beneficiary, depending upon the instant relation and the facts of the particular case, lies somewhere between simple negligence and willful misconduct or fraud with the intent to deceive. The actual intent to deceive is not required where one party is so placed in such an advantageous position to the other. Actual fraud will afford redress in the absence of the special relationship.

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relation to the corporation which they direct, their duty does not apply to the stockholder in the sale and purchase of stock. Dealing in its own stock is not a corporate function. In buying or selling stock, directors may trade like an outsider, provided they do not affirmatively act or speak wrongfully, or intentionally conceal facts with reference to it. There is also the qualification that no other relation of trust exists between the parties.' The numerical majority of the decided decisions have adopted the rule that courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock." Id. §1168.1.

"Under the minority rule directors are considered trustees for individual stockholders with respect to their stock, and this rule goes to the extreme of holding that they cannot purchase stock from a stockholder without giving him the benefit of any official knowledge they possess which may increase the value of the stock. [Citing Markey v. Hibernia Homestead Ass'n (La. App.), 186 So. 757]. This view has been adopted by a substanial number of cases and has been approved by practically every legal writer in this field." Id. §1168.2.

See also, 19 C.J.S., Corporations, §793 (b).

Louisiana has long recognized the fiduciary duty owed by corporate directors and officers to their individual stockholders. Her courts have applied it over and over, applying, it seems, the same standard of care to stockholders as owed by officers and directors to the corporation under Louisiana Revised Statutes 12:36:

> "Officers and directors shall be deemed to stand in a fiduciary relation to the corporation, and shall discharge the duties of their respective positions in good faith, and with that diligence, care, judgment, and skill which ordinarily prudent men would exercise under similar circumstances in like positions."

For brevity, these decisions are discussed in the margin.[6] We feel that these decisions fully answer appellant's contentions that Louisiana's limited equity jurisprudence will prevent our imposition of a "constructive trust" or "equitable lien" or "right of restitution" for the breach

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[6] See the case of Markey v. Hibernia Homestead Ass'n, La.App. 1939, 186 So. 757, 763, quoted at length in footnote 7 of the lower court's first opinion, 143 F.Supp. 826, 839, 840; and Commercial Nat. Bank in Shreveport v. Parsons, 5th Cir. 1944, 144 F.2d 231, 238-9, quoted in the lower court's opinion on the merits at 159 F.Supp. p. 119.

In Dawkins v. Mitchell, 1922, 149 La. 1038, 90 So. 396, 398-399, the Supreme Court of Louisiana stated:

> "The directors of the bank were its agents, charged under the law with an implied trust to use its funds only for the purposes permitted by law, and to preserve them for its creditors and stockholders . . . . The obligation which the directors incurred in favor of the bank was a special one, due to it in particular, and to the stockholders. It was not a general duty due to every one. They were elected by the stockholders to administer the affairs of the bank and accepted the trust.
>
> ". . . .
>
> ". . . still we should feel constrained to hold that a fiduciary relation existed between a shareholder of the bank and the members of the board of directors, and and that the duty which was due the shareholders was a special duty, and not a general one due everybody. The breach of that duty would be a breach of trust; and

of the fiduciary duty owed to the plaintiffs by defendant's officers.

We agree with the district court that the fiduciary relationship in this case necessitated a disclosure of the

therefore damages arising therefrom would be governed, not by the prescription of one year, but by that of 10 years. The shareholders elected the members of the board to administer the affairs of the bank and, the shareholders had a beneficiary interest in the bank. From this interest and from the acceptance of the trust by the directors there arose the special duty, due by the latter to the former, to faithfully administer that interest."

In Pool v. Pool, 1943, La.App., 16 So.2d 132, 135, the court stated:

"Directors are not liable for mere errors of judgment on their part where they act in good faith. They are only required to exercise reasonable care and diligence and act in good faith. But they are liable for willful neglect of duty, gross negligence or their fraudulent breach of trust. 19 C.J.S., Corporations, §764, p. 112 et seq.; 13 Am.Jur., Corporations, Section 992, p. 945 et seq.

". . . .

"If the petition is amended to set out the facts mentioned above, the plea of one-year prescription would not be good, for the reason that the relation between the defendants as directors and plaintiff as a stockholder was a fiduciary relationship and their duty to him was a special duty and not one which they owed to the general public. The prescription of ten years and not that of one year would apply. Dawkins v. Mitchell, et al., 149 La. 1038, 90 So. 396."

In Williams v. Fredericks, 1937, 187 La. 987, 175 So. 642, 644-645, the court reiterated:

"The directors of a corporation occupy a fiduciary relation to the stockholders generally, not only to the stockholders who elect them, but to all of the stockholders; and this fiduciary relation to the stockholders forbids a director to bind himself to use his official authority or prerogative for the personal benefit of any one. The leading case on the subject is West v. Camden, 135 U.S. 507, 10 S.Ct. 838, 34 L.Ed. 254, where the doctrine is stated thus: . . . ."

following facts admittedly not disclosed by defendant's officers to the plaintiffs:

"1. The $5,000,000 offer, for 55% of defendant's timberlands, made by R. O. Martin to Bud Johnson in 1952;

"2. The instructions given to C. L. Brooke, in 1952, to assume that defendant's assets possessed a value in excess of $9,000,000;

"3. The opinion of W. C. Postle, defendant's Chief Forester, in 1953, that its timberlands then had a market value 'in the neighborhood of a hundred dollars an acre', which the officers knew about;

"4. The letters containing tax advice, written by Brooke on August 29 and October 14, 1952, wherein contemplated plans for sale of defendant's assets, liquidation, merger, stock sales, etc., were discussed;

"5. The officers' secret consideration of various plans of liquidation, reorganization, merger, etc., before the stock-buying program was begun."

In Carey v. Dalgarn Const. Co., 1930, 171 La. 246, 130 So. 344, 347, this principle was further expanded:

"This court has said on numerous occasions, and particularly in McCloskey v. New Orleans Brewing Co., 128 La. 197, 54 So. 738, that courts will not interfere with the acts of a corporation in the absence of a clear showing of fraud or breach of trust.

"In Marcuse v. Gullett Gin Co., 52 La.Ann. 1383, 27 So. 846, the court said:

"'There is no necessity for the appointment of a special receiver to institute actions to recover from the officers and directors of a corporation, who hold a majority of its stock, property of the corporatin, which a stockholder charges them with having illegally diverted and appropriated to themselves as salaries.

"'The individual shareholder may himself bring such actions, by making the corporation, and the directors against whom relief is sought parties.'"

Johnson v. Mansfield Hardwood Lumber Company, W.D. La. 1958, 159 F.Supp. 104, 118, n. 9. Furthermore, the special relationship between defendant's officers and the plaintiffs demanded that restitution be made to plaintiffs for the difference of price in their sold shares and their value upon the almost immediate liquidation—especially where the defendant's officers made promises concerning curtailment of future dividends and disclosed plans for no liquidation in the near future and used economic coercion to secure the sale of the minority shares.

As the district court found, defendant's officers were the corporation. Other than their official nature, they were directors and also had in their control over one-half of the voting stock. They knew the intricate workings of the corporation, its total assets, and they knew more than the other stockholders about the value of the stock both for sale and upon liquidation. They used promises and representations as to their intended future running of the corporation which exerted economic influence on the plaintiffs, forcing them to sell, and then immediately began plans to liquidate in contradiction of their representations. Certainly, their fiduciary duty was violated to the plaintiffs-stockholders.

The district court answered appellant's contention that the officers rather than it or in conjunction with it were the proper parties defendant, as raised in its motion to dismiss, by quoting part of the following from *Kohler v. Jacobs*, 1943, 5th Cir., 138 F.2d 440, 442-443, which in our opinion, is good law:

> ". . . . As to the Corporation, it is true that it owes the stockholders no duty of disclosure when he trades with others in its stock, and since he has access to the corporate books diligence might

well lead him to them when he desires information from the Corporation. But if a corporation (which ordinarily does not deal in its own stock) for its own lawful purposes sets out to buy shares through its managing officers, and they by intentional misrepresentation and concealment deceive a selling stockholder who is ignorant of the truth, though he be an inactive director who ought to know, so that he is damaged, we see no reason why the corporation is not bound for the consequences. The deceit practiced by the corporation's high officers in the corporation's business and for its benefit must be taken to be a corporate act, and not ultra vires. 19 C.J.S., Corporations, §1278 (a)(b); 13 Am.Jur., Corporations, §1125. If on trial it should appear that the transaction was a deceit committed by Jacobs for the benefit of the Corporation, both the Corporation and himself as an individual might be liable; because the action is not one to rescind a fraudulent transaction, or to recover an unjust enrichment, but for the damages done by a wilful tort for which a perpetrator may be held liable though he realized no benefit from it. United States v. City of Brookhaven, 5 Cir., 134 F. 2d 442 . . . ."

Actually, however, the acts of defendant's officers in inducing the plaintiffs to sell were in all respects within their authority and not ultra vires—both Louisiana,[7] where the acts occurred, and Delaware,[8] where defendant

[7] Louisiana allows the purchase of treasury stock [State v. Stewart Bros. Cotton Co., 1939, 193 La. 16, 190 So. 317, 321-22], as Section 23, paragraph A of Act 250 of 1928 permits:

"A. Unless the articles otherwise provide, a corporation may purchase its own shares of any class issued by it, but only out of surplus available for dividends, and only if the purchase does not violate the contractural right of any other class of shares . . . ." L.R.S. 12:23A.

[8] Ashman v. Miller, 6th Cir., 1939, 101 F.2d 85, 90: "Section 19 of the General Corporation Act of Delaware (Rev. Code 1935, §2051) expressly confers on a corporation the power to purchase its own stock provided it can do so without impairing its capital."

See also, Bankers Securities Corp. v. Kresge Department Stores, 1944, D.Del., 54 F.Supp. 378

is incorporated, allow a corporation to purchase its own stock after meeting certain requirements (apparently satisfied here), and such acts were well within the implied, if not the express, authority of the officers' agency. Further, as covered by the trial court, there is no doubt about ratification by the corporation, if necessary at all, for breach of confidence. In fact, here, the corporation was the proper party defendant for satisfying all claims of all plaintiffs in one lawsuit. A stockholder derivative action certainly is not proper for, here, the wrong is to the individual plaintiffs and not to the corporation." And the general rule that "a corporation is not relieved from liability for the fraudulent acts of its officers within the apparent scope of his authority, by the fact that the officer in committing the fraud is acting for his own benefit, and the corporation does not profit from it,"[9] applies as strongly where a fiduciary breach is substituted for fraud.

Appellant earnestly predicates separate defenses to the claims of four plaintiffs, Max Brown, Mrs. Hattie A. Johnson, Mrs. Jeanette Johnson Jennette, and Ben Drew Velvin, Executor, who collectively assert more than eighty-four per cent in value of the claims. As to these first three plaintiffs, discussed by the lower court at 159 F.Supp. pp. 127-131, we must summarily hold that the facts conclusively warrant an affirmance on the basis of the breach of fiduciary relationship existing to them from the corporate officers and especially on the "business duress" practiced on Brown. Their special defenses are of no avail. To further elucidate would be repetitious. Ben Drew Velvin, as executor and sole heir of his mother, a party plaintiff having died during this litigation, may pursue the claim which she had asserted. We do not

[9] See Fletcher, Cyclopeida Corporations, Perm.ed., §5911.
[10] Annotation, 43 A.L.R. 615.

feel that his opinion testimony that there was no fraud would prevent him from pursuing his claim as executor.

We do hold that the trial court was clearly erroneous in its findings as to the Shreveport Lumber Sales, in commenting on the excessiveness of the officers' salaries and expense accounts, and in holding "that the officers probably bought a large amount of timber from outside sources, instead of cutting from defendant's timberlands, thus maintaining their value for purposes of future liquidation," all found at 159 F.Supp. p. 111. In fairness to defendant's officers, we record our opinion that such findings are clearly erroneous, notwithstanding that our so holding does not change the result.

The judgment is

AFFIRMED.

JUDGMENT

Extracts from the Minutes of February 20, 1959

No. 17299

MANSFIELD HARDWOOD LUMBER COMPANY,

versus

HATTIE A. JOHNSON, ET AL.

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Louisiana, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered and adjudged that the appellant, Mansfield Hardwood Lumber Company, and the sureties on the appeal bond herein, Brown McCullough and T. W. M. Long, be condemned, in solido, to pay the costs of this cause in this Court for which execution may be issued out of the said District Court.

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 17299

MANSFIELD HARDWOOD LUMBER COMPANY,

Appellant,

versus

HATTIE A. JOHNSON, ET AL.,

Appellees.

Appeal from the United States District Court for the Western District of Louisiana.

(June 16, 1959.)

ON PETITION FOR REHEARING.

Before RIVES, TUTTLE and BROWN, Circuit Judges.

PER CURIAM: Interpreting the opinion as being based on a breach of fiduciary relationship owed by appellant's officers and directors and majority stockholders to the appellees as minority stockholders, appellant insists that such a decision must fail in law because: (1) the ex-

istence vel non of such a fiduciary relationship must be determined by the laws of the state of incorporation, viz., Delaware, which imposes no such fiduciary relationship; (2) the Civil Law of Louisiana prohibits the imposition of the remedy of "constructive trust" or "equitable lien" on real or personal property; and (3) Article 1847, La. Civil Code,[1] requires that there be an element of "intent" or "design" for an action to be based on fraud; and liability predicated on "constructive fraud" is unknown in Louisiana Civil Law.

Upon further consideration, we agree that the opinion is at least misleading, particularly to Louisiana jurists who practice under that State's unique concepts of equity jurisprudence. We will attempt to clarify and correct the basis for our holding.

We initially expressed doubt that the defendant's officers were guilty of fraud per se because of our doubt that the naked "intent to deceive" element was adequately established. We next held that a "growing minority" of jurisdictions, including Louisiana recognize a fiduciary relationship or a position of confidence existing between the directors and officers of a corporation and the in-

[1] Article 1847, La. Civil Code, reads in part:

"Fraud, as applied to contracts, is the cause of an error bearing on a material part of the contract, created or continued by artifice, *with design* to obtain some unjust advantages to the one party, or to cause an inconvenience or loss to the other. . . ." (Emphasis supplied)

Article 1848, La. Civil Code, reads:

"Fraud, like every other allegation, must be proved by him who alleges it, but it may be proved by simple presumptions or by legal presumptions, as well as by other evidence. The maxim that fraud is not to be presumed, means no more than that it is not to be imputed without legal evidence."

dividual stockholders, especially when the former purchase shares of stock from the latter. And we held that, when this fiduciary duty is violated, it is

> "... immaterial whether its breach is described as constructive fraud, unjust enrichment, fraudulent breach of trust, breach of fiduciary obligation, gross negligence, or otherwise, and whether the remedy is given by a constructive trust, restitution, or accounting. These are all relative terms describing broad equitable concepts. The standard of a fiduciary's duty to his beneficiary, depending upon the instant relation and the facts of the particular case, lies somewhere between simple negligence and willful misconduct or fraud with the intent to deceive. The actual intent to deceive is not required where one party is so placed in such an advantageous position to the other. Actual fraud will afford redress in the absence of the special relationship."

We concluded by holding that Louisiana has long recognized the fiduciary relationship in situations like the present case, and that these Louisiana decisions "fully answer appellant's contentions that Louisiana's limited equity jurisprudence will prevent our imposition of a 'constructive trust' or 'equitable lien' or 'right of restitution' for the breach of the fiduciary duty owed to the plaintiff by defendant's officers." Then, we listed the ways in which this confidential relationship was violated.

We believe that all of what was said above is good law, both in common-law States and in Louisiana, except for the possible misleading construction which could be placed on the statements which describe the breach of

this duty and the remedy in broad equitable concepts as applying literally to Louisiana law. We agree with appellant that the Louisiana Civil Law prohibits the imposition of a constructive trust or equitable lien on property.[2]

We stated that a "growing minority" of jurisdictions recognize the existence of a fiduciary relationship inuring from the officers or directors or majority shareholders to the individual or minority shareholders, particularly concerning the purchase of stock from a shareholder.[3] The next question presented is which law should determine this relationship—that of Delaware or Louisiana?

It is well settled that a federal court in a diversity case must apply the conflict-of-law rule of the state in which it sits.[4] While Louisiana conflict-of-law is silent on which law determines whether such a fiduciary re-

[2] *E.g.*, Succession of Onorato, 1951, 219 La. 1, 51 So.2d 804, 810.

[3] Fletcher, Cyclopedia Corporations, perm.ed., §§1168-1171. It is noted that "there has been a growing tendency to break down the harsh majority rule that the purchasing director (or officer) owes no affirmative fiduciary duty to disclose to the shareholders by finding exceptions in special circumstances giving rise to a duty to make disclosure, where otherwise there would be a great and unfair inequality of bargaining position by the use of inside information . . . . The opinion has been expressed that this special circumstances doctrine seems likely to supersede both of the older views" Ballantine, Law of Corporations (Rev.ed.), pp. 213-216, as quoted in Fletcher, op.cit. supra, §1174. This special circumstances or facts doctrine, as crystalized in the landmark case of Strong v. Repide, 1909, 213 U.S. 419, has been followed by many jurisdictions. Fletcher op.cit., supra, §1171.

The "special facts" and the minority view are also found in Rule X-10B-5 of the Securities Exchange Commission to supplement Section 10(b) of the Act (15 U.S.C.A. §78j).

[4] Klaxon Co. v. Stentor Elec. Mfg., Co., 1941, 313 U.S. 487, 496; Palmer v. Chamberlin, 5th Cir. 1951, 191 F.2d 532, 536.

lationship exists in a foreign corporation, its various conflict-of-laws rules are generally the same as in other states.[5] Therefore, we must look to the general law.

A number of cases have held that the conflict-of-laws rules of the forum require that court to refer to the "law of the State of incorporation to determine the extent and nature of relationship between corporation and stockholder, corporate officer or director and stockholder and between stockholders inter sese,"[6] while the law of the place of the wrong determines the quantum of the breach of duty.[7] Apparently, Delaware imposes no fiduciary duty on the part of officers or directors or majority shareholders in buying stock from the minority or in-

[5] For instance, the law governing the right of action in tort is the *lex loci delicti* (Matney v. Blue Ribbon, 1943, 202 La. 505, 12 So.2d 253, aff'g 12 So.2d 249; Mock v. Maryland Casualty Co., 1942, 6 So.2d 199), the law governing the performance of contracts is the place of performance (Vidal v. Thompson, 1822, 11 Mart. (D.S.) 23; Palmer v. Chamberlin, supra), and the law of the forum governs matters of procedure (Macomber v. DeBardeleben Coal Co., 1941, 4 So.2d 483, vacating 200 La. 633, 8 So.2d 624.

[6] Zahn v. Transamerica Corporation, 3rd Cir. 1947, 162 F.2d 36, 40. See also, Rogers v. Guaranty Trust Co., 1933, 288 U.S. 123, 130; Perlman v. Feldman, 2d Cir. 1955, 219 F.2d 173, 175; Mayflower Hotel Stock P. Com. v. Mayflower Hotel Corp., D.C.Cir. 1951, 193 F.2d 666, 668; Maxwell v. Enterprise Wall Paper Mfg. Co., 3rd Cir. 1942, 131 F.2d 400, 402; Geller v. Transamerica Corp., D.Del. 1943, 53 F.Supp. 625, 629-630; aff'd 151 F.2d 534; Hirshhorn v. Mine Safety Appliance Co., W.D.Pa. 1952, 106 F.Supp. 594, 600; aff'd 203 F.2d 279; Fayes, Inc. v. Kline, S.D.N.Y. 1955, 136 F.Supp. 871, 872.

However, in Blazer v. Black, 10th Cir. 1952, 196 F.2d 139, the court applied Kansas law to determine the fiduciary nature of the parties of an Illinois corporation where all the operative facts occurred in Kansas.

[7] Zahn v. Transamerica Corporation, Geller v. Transamerica Corp., and Hirshhorn v. Mine Safety Appliances Co., supra.

dividual stockholders.[8] In strict logic, a strong case is made that, if this Court's opinion is based exclusively on the breach of fiduciary obligations owed by directors and majority stockholders of a foreign corporation to

[8] Cahall v. Lofland, 1921, 12 Del. Ch. 299, 114 Atl. 224, 228. This case contained the following quote from DuPont v. DuPont (D.C.), 242 Fed. 98, 136:

"The duties of a director or other officer of a corporation in transactions where he is representing his company are governed by well-established and familiar rules of equity. A director of a corporation may freely purchase its stock, and occupies no relation of trust to an individual stockholder which prohibits his using whatever advantage his position may afford him through knowledge of its business and condition superior to that of the stockholder with whom he deals. He is not accountable to the stockholder for withholding information from him which affacts the value of the stock, but to the corporation, the whole body of stockholders, he stands in a fiduciary relation which requires him to exercise the utmost good faith in managing the business affairs of the company with a view to promote, not his own interests, but the common interests, and he cannot directly or indirectly derive any personal benefit or advantage by reason of his position distinct from the coshareholders . . ." (114 Atl. 224, 228.)

Cahall v. Lofland, supra, actually involved the fiduciary duty of directors *to the corporation* and was affirmed on that premise at 118 Atl. 1.

Another Delaware authority is the case of Allied Chemical & Dye Corp. v. Steel & Tube Co., 1923, 14 Del.Ch. 1, 120 Atl. 486, 491. This case involved the sale of assets and franchises of the corporation under the auspices of 29 Del. Laws, c. 113, §64A, and the validity of the sale was challenged by the minority shareholders. The Chancellor stated:

"... An examination of the cases to which special attention is directed by the complainants in this connection will disclose that the personal advantage accuring to the majority is in some way derived from, or intimately associated with, the corporate assets themselves." (120 Atl. 491.)

See, also, Brophy v. Cities Service Co., 31 Del. Ch. 241, 70 A.2d 5, in which an employee of a corporation, acquiring knowledge in the course of his employment that the corporation secretly intended to purchase large blocks

minority shareholders, and if literal compliance is given to those decisions holding that the State of incorporation sets the standards for all personal relationships between persons connected with the corporation, the opinion is faulty.

Those decisions (listed in footnote 6, *supra*) are, however, in our opinion, either inapplicable or unsound where the only contact point with the incorporating state is the naked fact of incorporation, and where all other contact points, such as, residence of parties and actors, situs of property, lex loci delicti or contractus, place where corporation is conducting its only or principal place of business, et cetra, are found in another jurisdiction. Certainly, in such a situation the charter of the corporation and even non-repugnant statutory laws of the state of incorporation limiting corporate powers should govern the internal affairs of the corporation.[9] When, however, the situation is such as here, where neither the charter nor the statutory laws of the incorporating state are applicable, and *all* contact points are in the forum, we believe that the laws of the forum should govern.[10]

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of its capital stock in the market, cannot use such information for his personal gain.

Delaware also places a high fiduciary duty upon interlocking directorates regarding transactions between the corporations. Keenan v. Eshleman, 1938, 23 Del.Ch. 234, 2 A.2d 904.

However, Cahall v. Lofland, supra, has been followed uniformly by federal courts in interpreting the Delaware law on this subject. See Zahn v. Transamerica Corp., supra, 162 F.2d 36, 40, and cases there cited; Mayflower Hotel Stock P. Com. v. Mayflower Hotel Corp., supra, 193 F.2d 666, 668, 669, 671.

[9] 17 Fletcher, Cyclopedia Corporation, §§8318, 8326. For visitatorial powers of a state over foreign corporations, see Sections 8425-8445.

[10] Shares of stock are much like other chattels. Apparently, when the action attacks a transfer of a chattel on the ground of fraud, the law of the state where the chattel is at the time of transfer determines the substantial

This was precisely the situation in *Blazer v. Black*, *supra*, note 6, 196 F.2d 139, involving a suit by a former stockholder of a dissolved corporation against its former president for damages for the alleged fraudulent conversion of the stockholders' stock before dissolution. The corporation was organized under the laws of Illinois but all other contacts were in Kansas. The court reversed the lower court's judgment for defendant, holding that, under minority view of Kansas, the director was a fiduciary when negotiating with a shareholder for purchases of shares. The court did not discuss the law of Illinois.

In the case of *Mayflower Hotel Stock P. Com. v. Mayflower Hotel Corp.*, *supra*, note 6, 193 F.2d 666, the District of Columbia Circuit had held in a prior appeal (173 F.2d 416) that the directors or majority stockholders occupy a fiduciary relation toward the minority stockholders when selling stock control, relying on Supreme Court decisions which arose under federal statutes or which were diversity cases prior to *Erie R. Co. v. Tompkins*, 1938, 304 U.S. 64. On the second appeal, after the defendants presented the question that Delaware law

validity of the transfer. Restatement, Conflict of Laws, §257 and Comment a, provide:

"Whether a conveyance of a chattel which is in due form and is made by a party who has capacity to convey it is in other respects valid, is determined by the law of the state where the chattel is at the time of the conveyance.

"*Comment:*

"*a. Illegality and fraud.* The validity of a conveyance of an interest in a chattel alleged to be void between the parties for such reasons as illegality of the transfer or illegality of the consideration or other reasons, or alleged to be voidable between the parties for fraud or other cause which affects its substantial validity, is determined by the law of the state where the chattel is at the time of conveyance."

should control such fiduciary relations, the court declined to consider whether the "law of the case" applied to second appeal matters determined on a first appeal (193 F.2d at p. 669) and held, as a concurrent ground for imposing these high standards, that the District of Columbia and Delaware law is in substantial accord in imposing a fiduciary relationship on a majority stockholder regarding transactions between corporations with interlocking directorates. (193 F.2d at p. 671.)

Most of the other cases listed in footnote 6, *supra*, involve situations where the courts were seeking to impose the fiduciary rule of the state of incorporation in order to escape the inequitable rule of the forum (generally Delaware).

However, in view of our holding hereinafter that the district judge was not clearly erroneous in holding that the actions of appellant through its officers constituted actionable fraud under Article 1847, Louisiana Civil Code, what has been said concerning the choice of laws to determine the duty owed by officers, directors, or majority stockholders to the minority shareholders may not be necessary for the disposition of this case. That is true because, as will be seen, the broad scope of fraud in Louisiana covers situations where the law imposes an obligation on the party with superior knowledge to disclose facts within his knowledge to the other and to deal in an atmosphere of trust and confidence. Since appellant's officers had such superior knowledge, Louisiana fraud rules demanded open and disclosed dealings with utmost fairness.

As stated earlier, the equitable remedies of constructive trust or equitable lien are alien to the civil law.

Without these remedies and with the rule that "constructive fraud," found in the law of fiduciaries and characterized by the lack of the "intent to defraud,"[11] is impossible under Article 1847,[12] Louisiana courts have an awkward time imposing liability for the breach of a fiduciary's duty to disclose or the breach of other fiduciary relations.[13] In some cases involving a relationship of confidence between the parties, the Louisiana courts have used the terms of common-law equity, ordinarily obnoxious to the civil law, to describe the breach and remedy for breach of fiduciary duty, such as, "breach of trust" and "constructive trust."[14] Normally, however, the Louisiana courts,

[11] The doctrine of "constructive fraud" at common law, being the breach of a legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent, is well discussed in Hornaday v. First National Bank of Birmingham, Inc., 1952, 65 So.2d 678, 687.

[12] In Buxton v. McKendrick, 223 La. 62, 64 So.2d 844, 846, the Louisiana Supreme Court (quoting from Slocomb v. Real Estate Bank of Ark., 2 Rob. 92) said:

"'Two things are necessary to constitute fraud: the intention to defraud, and actual loss or damage, or such strong probability of it as will induce a court to interfere.'"

In Garnier v. Aetna Insurance Co., 181 La. 426, 159 So. 705, 707, the Louisiana Supreme Court said:

"The defendant (one alleging fraud) therefore carried the burden of proving, not only that plaintiff made misrepresentations, but also that they were knowingly made with fraudulent intent."

In Poitevant & Favre Lumber Co. v. Standard Planing Mill & M. Co., 49 La. Ann. 72, 78, 21 So. 194, 196, the Louisiana Supreme Court said:

"Our predecessors have frequently employed, in this connection, such emphatic language as this, viz: 'To constitute fraud, there must be an intention of defrauding consilium fraudis, and an actual loss, eventus damni.'"

[13] See the difficulties confronting the courts in Succession of Onorato, supra, note 1, 51 So.2d 804, 810, 816, and in Griffing v. Atkins, 1941, 1 So.2d 445, as discussed in note 16, infra.

[14] For instance, in Watkins v. North American Land & Timber Co., 1902, 107 La. 107, 31 So. 683, 685, the court

in finding liability for a breach of a fiduciary duty, have based such liability on "fraud" as encompassed in Article

reversed a lower court judgment for defendants and remanded the case for trial where:

"The contention of the defendants is that the petition exhibits nothing more than an attempt by a stockholder to control, with the aid of the court, the action of the managing agents of the corporation, representing the majority of the stockholders, and that this cannot be done in the absence of allegations of fraud, ultra vires, breach of trust, or gross negligence or misconduct, none of which are alleged . . . ."

In Haynesville Oil Co. v. Beach, 1925, 159 La. 615, 105 So. 790, 791, the court held:

". . . . The fact is, however, that defendant, whilst commissioned to purchase the rig in the name of plaintiff, nevertheless purchased it in his own name, using plaintiff's money for that purpose. This was a breach of trust and the title which defendant obtained to said rig inured to the benefit of plaintiff, whom he represented. McClendon v. Bradford, 42 La.Ann. 160, 7 So. 78, 8 So. 256.

". . . . . .

"We hold that the drilling rig is the property of plaintiff."

And in Succession of Bienvenu, 1901, 106 La. 595, 31 So. 193, 194, the court stated:

". . . . The company signed its name to the deed really as her agent and representative. In observing the form of selling the property to her, as relates to the land it held and which had been bought with her money in compliance with agreement, it only placed her in possession of her property. The company, from the date of the deed to it, held the property in trust. . . .

". . . . We have seen that the parties to the agreement had created a constructive trust, under which the homestead company held temporarily for the real owner. Improvements placed on property held in trust with the consent of the owner must be accounted for when the property is delivered to the owner. . . ."

And in McClendon v. Bradford, 1890, 42 La.Ann. 160, 7 So. 78, 79, where an agent acquired an interest adverse to his principal, the court stated:

". . . . The title they obtained to said Rosanna Harris' land claim, and through which they had obtained patent issued to them as the owners of the same, must inure to the benefit of the parties whom they represented. It was

1847 of the Civil Code. This is true in cases involving both corporate fiduciaries[15] and other fiduciaries.[16] There-

a constructive trust, which they held for the benefit of their principal. . . ."

To the same effect, see Assunto v. Coleman, 1925, 158 La. 537, 104 So. 318, 319.

See also, Jansen v. Bellamore, 1929, 167 La. 900, 903, 120 So. 324, 327-329.

[15] In Markey v. Hibernia Homestead Ass'n, 1939, 189 La. 757, 764, a case relied on by this Court in its prior opinion, the plaintiff sued "to recover damages she claims to have sustained as the result of a scheme allegedly concocted by the defendants by which she charges that she was fraudulently induced to sell to the homestead 17 shares of its capital stock (par value $100 per share) for $50 per share." After fully discussing the fiduciary duty owed by defendant directors to the plaintiff, the court stated:

"It is to be observed here that the defendant directors were not purchasing plaintiff's stock with their own funds. On the contrary, they were using the assets of the corporation for that purpose. It seems too plain for extended argument that, under such circumstances, they became trustees for all of the stockholders and that if they concealed in bad faith any facts from any one of the persons affected by the plan they devised, they should be made to respond for their deceit."

And the court concluded:

"A careful analysis of plaintiff's petition and the exhibits attached thereto justifies the conclusion that she states a case of actionable fraud."

The case was reversed for trial and after judgment for defendants, plaintiff prosecuted her second appeal. The court in Markey v. Hibernia Homestead Ass'n, 1943, 13 So. 2d 791, 795, states:

". . . . In other words, the complaint is that the defendants fraudulently devised a scheme to unjustly enrich themselves at plaintiff's expense. It was because of these charges that we, in our first opinion, (see La.App., 186 So. 757), reversed the judgment of the court below and maintained plaintiff's cause of action. Later, in a similar case (but where no allegations of actionable fraud were set forth), the Supreme Court maintained an exception of no cause of action in a suit by a stockholder of a homestead to have a sale of her stock to the homestead rescinded. See Wessel v. Union Savings & Loan Ass'n, 198 La. 21, 3 So. 2d 594.

"The evidence in the case discloses, beyond question, that there is no foundation in fact for plaintiff's charge

fore, the breach of the relationship is called fraud and the remedy is, of course, a rescission of the contract or

> that the Directors of the homestead conspired to recapture her stock for their own benefit . . . ."
>
> While the court had presented the question of whether or not "bad faith" need to be shown when misrepresentations are made by a defendant in a fiduciary capacity, the court held that no misrepresentations were made, and did not decide this question:
>
> "Counsel for plaintiff contends that, in spite of the fact that the Board of Directors had no intention of enriching themselves at plaintiff's expense, the defendants are, nevertheless, responsible because,—(1) they misrepresented to her the sound, or book value, of her stock . . . . And it is further argued that, in view of the fiduciary relationship existing between the defendants and the stockholders of the homestead it is immaterial whether the alleged misrepresentations were made by the defendants in bad faith or not.
>
> "The first contention, that the defendants misrepresented the value of the homestead stock, is wholly without merit. The various communications mailed to the shareholders exhibit that the defendants made no representations with respect to the value of the stock . . . ." (13 So.2d 791, 796.)

In Pool v. Pool, 1943, 16 So.2d 132, 133, also cited in the first opinion, the suit was against the directors individually to recover for the individual liability imposed on plaintiff after the liquidation of the corporation: "all of which was caused by the negligence, lack of skill, malfeasance, neglect, actionable deceit and fraud on the part of the defendants." After setting out the liability of directors to individual stockholders for "wilful neglect of duty, gross negligence on their fraudulent breach of trust" and after holding that the prescription of ten years would apply "for the reason that the relation between the defendants as directors and plaintiff as a stockholder was a fiduciary relationship and their duty to him was a special duty and not one which they owed to the general public," the court reversed the case and allowed plaintiff to amend his petition.

In Commercial Nat. Bank in Shreveport v. Parsons, 5th Cir. 1944, 144 F.2d 271, 278-9, the court stated that "a hard bargain driven by fiduciaries in such circumstances is presumed to be fraudulent and void."

In the case of Wessel v. Union Savings & Loan Ass'n., 1941, 198 La. 219, 3 So.2d 591, 595, 598-599, not cited in the first opinion, the plaintiff alleged that defendant was guilty

damages.[15] By bringing such relationship under the broad heading of fraud, the Louisiana courts have, in ef-

of fraud because it induced her to sell her stock at a price which was less than its book value or its value on the open market. The plaintiff alleged that:

". . . the association and its officers knew or should have known that the stock had a greater value than that which they represented in the circular letter, and that by means of this letter the president and secretary of the association conspired to conceal and did conceal the true value of the shares of stock, and thereby took an unfair advantage of their fiduciary relation and of the trust and confidence which the plaintiff and other shareholders had and were entitled to have in the officers and directors of the association." (3 So.2d 594, 595.)

The court, in holding for the defendant homestead association, stated:

"It is declared in the third paragraph of article 1847 of the Civil Code that a false statement made by a party to a contract of sale, as to the value of the object of the sale, is not such a fraud, 'such an artifice,' as will give to the other party the right to annul the sale, if the object was of such a nature and in such a situation that he who was induced by the false statement to enter into the contract 'might with ordinary attention have detected the falsehood'. Therefore, if the statement in the circular letter which induced the plaintiff to sell her shares of stock for $50 per share, that the listing of the stock would be reduced to $38 on the nineteenth day after the date of the circular letter, should be regarded as a false statement, it was not a false statement of which the plaintiff may complain, because 'with ordinary attention' she could have learned all that any one else could know about the value of her shares of stock. On account of the fiduciary relation of the officers and directors to the stockholders of a corporation, the third paragraph of article 1847 of the Civil Code might not be deemed applicable to this case if the president and secretary of the Union Homestead Association had withheld from the plaintiff any information concerning the value of her shares; but that is not the case." (3 So.2d 594, 598-599.)

[15] See cases in note 14, supra.

In Succession of Onorato, 1951, 219 La. 1, 51 So.2d 805, 810, the plaintiffs attempted to recover the net proceeds of life policies made payable to the deceased's executors for the reason, inter alia, that, while deceased was acting as their agent in maintaining their properties, the premiums paid to maintain these policies in force were paid from

fect, reached the same results as would be reached under the common-law — results which seem to common-law

rental revenues collected by him in his fiduciary capacity, "and that accordingly a constructive trust or equitable lien has been impressed upon the insurance proceeds in their favor." The court stated this contention as follows:

"We now come to appellants' fourth and last contention, that the premiums paid to maintain these insurance policies in force while deceased was acting as their agent were paid from rental revenues collected by him in his fiduciary capacity and misappropriated to his own use, and that under these circumstances they are entitled to recover the net proceeds realized from these policies.

. . . . . .

"Appellants base the contention now being considered on fraud, and this fraud is the more reprehensible because committed by the deceased in breach of a fiduciary relationship against those to whom he owed the utmost sincerity and fidelity." (51 So.2d 804, 810.)

After holding that the legislature did not intend for the statutory provision exempting the proceeds of life insurance from debt to apply to proceeds received as a result of a fraudulent act, the court allowed recovery.

Justice McCaleb, dissenting in part, stated:

". . . . For my part, I see no difference, insofar as the application of the legal exemption is concerned, between debts which emanate from legitimate causes and those resulting from a breach of trust. Surely, the statute makes no distinction in this regard and it is not our function to write such an exception into the law. Nulsen v. Herndon, 176 La. 1097, 147 So. 359, 88 A.L.R. 236. True enough, a majority of the common law states provide authority for the prevailing opinion but those pronouncements are founded on the constructive trust or equitable lien doctrine, which is unknown in Louisiana; albeit, the antithesis of the provisions of our Code dealing with privileges." (51 So.2d 815-816.)

In Griffing v. Atkins, 1941, 1 So.2d 445, 449, 450, an ignorant Negro intervened in the suit seeking to rescind a sale of a $1250 diamond ring, which he had found, and which was purchased from him by a jeweler for $150.00. The court held:

"The ground on which Sims, the intervenor, seeks to set aside the sale is of course one arising out of the Articles of our Civil Code relating to error and fraud. Under Art. 1819, there are four defects of consent which will invalidate any contract entered into by the parties, viz.: Error; Fraud; Violence; Threats. We are concerned

lawyers hard to obtain under a literal interpretation of the Civil Code.[18]

with the first two, but in reality this case involves the second thereof for the reason that Art. 1832 provides that: 'In all cases, however, when the information, which would have destroyed the error, has been withheld by the other party to the contract, it comes under the head of fraud, and invalidates the contract.' The article relative to the nullity of contracts from fraud is Art. 1847. The preliminary statement of that article is the most important as it defines fraud, as it applies to contracts, as 'the cause of an error bearing on a material part of the contract, *created or continued by artifice, with design to obtain some unjust advantages to the one party, or to cause an inconvenience or loss to the other*' (italics scoring ours). From this definition, the article then lays down twelve certain rules which it says are drawn therefrom. In rule 4, we find particular reference to false assertions constituting an artifice regarding objects that require particular skill or habit, or any difficult or inconvenient operaton to discover the truth or falsity of the assertion; examples are given therein but they are not inclusive. Rule 5 provides that fraud arises from some false assertions made as to the value or quality of the object forming the subject of the contract or by the suppression of what is true regarding the same. Rule 6 provides that: 'The assertion and suppression, mentioned in the last preceding rule, mean not only an affirmation or negation by words either written or spoken, but any other means calculated to produce a belief of what is false, or an ignorance or disbelief of what is true.' These rules contemplate that in a contract of sale of the very nature of the one with which we are now concerned that where the parties are on an unequal footing, and not dealing at arms length, the one possessing the superior knowledge regarding the value or the quality of the object is held to the exercise of the greatest care and caution in conducting himself and must not take undue advantage of the other party, who, as it happens in this case, is one totally ignorant of the value or quality of the object and who was attempting to obtain information relative thereto.

"In this case, Sims went to Roumain's store upon the solicitation of one of the employees where he had the right to expect a full and complete disclosure of the facts and of the truth regarding the ring. He did not know Roumain, Collins or Griffing. He went there for technical advice as to the character and value of the ring. All of these, in our opinion, were in a fiduciary or quasi-fiduci-

It is also apparent that these same results are achieved when the Louisiana courts hold:

> "In determining whether or not fraud has been proved, the situation of the parties and the circumstances surrounding the transaction may be taken into consideration." *Herring v. Louisiana Industrial Life Ins. Co.*, La.Ct.App. 1940, 195 So. 67, 69;

and when they hold:

> "Considerable stress is laid by counsel for plaintiff on the question of the proof that is generally required to show that fraud exists. Whilst it is true that in Article 1848 of the Civil Code it is provided that fraud, like every other allegation, must be proved by him who alleges it, however, that same article further provides that 'it may be proved by simple presumptions, or by legal presumptions as well as by other evidence.' The maxim that fraud is not to be presumed, means no more than that it is not to be imputed without legal evidence.' Courts have always acknowledged how difficult it is for one to prove fraud by positive and direct testimony, realizing full well that those who indulge in it generally prepare themselves in such a manner as to cover up and leave no traces of their practice

ary relationship towards him, and Sims had a right to expect, in fair dealing, the true information which he had been invited to seek there; and no one, especially under the circumstances as we view them, where all of them had the knowledge of the ring's true character and value, should have taken advantage of him and attempted to buy the ring at a price which was so much out of proportion to its true value."

[17] The remedy given by the district court as affirmed by this Court is a rescission of the sales of plaintiffs' stock to defendant, a recognition of the plaintiffs as the owners of said stock, and an order for accounting following judgment for plaintiffs "against defendant for their pro rata portion of the assets of defendant distributed in liquidation, said portions to be credited with the amount each plaintiff received for his stock."

[18] See the cases in notes 14, 15, and 16, *supra*.

behind them. In an early case, Simon-Gregory Co. v. Newman, 50 La.Ann. 338, 23 So. 329, the Court stated that: 'While fraud is never to be presumed, courts of justice "recognize the cunning concealment in which it shrouds its devious practices and the difficulty of tracing it by direct proof." ' We can well conceive of such a situation in this case where such practices may well have been indulged in and it becomes next to impossible to put our finger on any particular piece of direct testimony to show actual fraud on the part of Griffing. As a matter of fact his fraud wasn't active but rather of a passive nature in that he failed to disclose the information which he was in justice and in equity bound to disclose to the other party to the contract who was not on an equal footing with him. He suppressed the truth, and therefore the case comes within the rules laid down in our Civil Code." *Griffing v. Atkins, supra*, 1 So.2d 445, 450;

and when they hold:

". . . . 'Fraud,' as the word is used in our Code and in courts of equity, as relates to contracts, 'comprises all acts, omissions and concealments involving a breach of legal or equitable duty and resulting in damage to another'," *Thieme v. Collier*, La.Ct.App. 1930, 128 So. 730, 731;

and when they hold:

". . . . While a purchaser is under no obligation to inform a prospective vendor as to the value, the title or the condition of the property involved, he, individually, or as agent for his principal, having made representations and statements as to the value, the title or the condition of the property, knowing them to be false or reckless or without knowledge of their truth or falsity, is under the solemn obligation to make correct representations and tell the whole truth, without concealment or suppression of any material facts, especially if

there exists an inequality of knowledge, as where the seller does not reside near the land and the purchaser does and is familiar with it," *American Guaranty Co. v. Sunset Realty & Planting Co.*, 1945, 208 La. 772, 23 So.2d 409, 449;

and when they hold:

"'Two things are necessary to constitute fraud: the intention to defraud, and actual loss or damage, or such strong probability of it as will induce a court to interfere.' (Slocomb v. Real Estate Bank of Ark., 2 Rob. 92)." *Buxton v. McKendrick*, 1953, 223 La. 62, 64 So.2d 844, 846;

and when they hold:

"The rule of equity, briefly stated, is that a purchase by a trustee or agent per interpositam personam carries fraud on its face. Michoud's Case, 45 U.S. (4 How.) 552, 11 L.Ed. 1076." *Cuggy v. Zeller*, 1913, 132 La. 222, 61 So. 209, 212.

We have not overlooked the matters pretermitted on pages 8 and 9 of the slip opinion, but we think that those matters have been sufficiently covered in the opinions of the district court and of this Court and that the contentions there pretermitted are without merit.

In our original opinion we wrote too much in the language of the traditional equity jurisprudence familiar to lawyers in common-law states. The evidence viewed in the light of the civil law, including the principles just discussed, removes the doubt which we held "that the 'intent' element necessary as the basis for actual fraud was adequately established." In view of the confidential

relationship existing between th parties, and considering the circumstances surrounding the transactions, we now hold that the district court was not clearly erroneous in holding that the necessary "intent" had been established to constitute actionable fraud in Louisiana. The petition for rehearing is therefore

DENIED.

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JAMES R. BROWNING, Clerk

No. 371

Supreme Court of the United States

OCTOBER TERM, 1959

MANSFIELD HARDWOOD LUMBER COMPANY,

Petitioner

versus

HATTIE A. JOHNSON; JEANETTE JOHNSON JENNETTE; CORA HARREL, Administratrix of the Estate of Mamie E. Harrel; J. A. HARREL; ELIZABETH HARREL WALKER; RUTH HARREL MULKEY; MAX BROWN; ALICE S. H. BROWN; and DREW VELVIN, Executor of the Estate of Minnette Velvin,

Respondents

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF HATTIE A. JOHNSON, ET AL, IN OPPOSITION

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Respondents

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF HATTIE A. JOHNSON, ET AL, IN OPPOSITION

QUESTIONS PRESENTED

Whether purchases of stock for less than one-fifth its value from minority stockholders by a closely held family corporation, in its name and with its funds, pursuant to misrepresentations, suppression of facts and economic coercion accomplished through its majority stock-

holders and officers are voidable under the law of Louisiana as fraudulently induced?(1)

STATEMENT

Respondents, former minority stockholders of the petitioning corporation, charged, inter alia, that their stock was purchased by the corporation for less than one-fifth its value, through a fraudulent scheme conceived and executed by the majority stockholders and principal officers. Promptly upon the corporation's purchase of the stock, the corporation was caused to sell its assets and liquidate and the majority stockholders realized for themselves a profit of more than $3,400,000 at the expense of respondents.

Respondents sought, before the United States District Court for the Western District of Louisiana, to establish their right to recover that portion of the assets of the corporation in liquidation they would have received had they not been unlawfully deprived of their stock. To that end they prayed: (1) for judgment rescinding their stock purchases; (2) for judgment recognizing their right to a pro rata portion of the assets of the corporation in liquidation, less the amounts received for their stock; and (3) for an accounting by the corporation to determine the exact value of this pro rata portion.

---

(1) If certiorari is granted, respondent wishes also to raise additionally the following questions:
Whether purchases of stock for less than one-fifth its value from minority stockholders by a closely held family corporation, in its name and with its funds, pursuant to misrepresentations, suppression of facts and economic coercion accomplished through its majority stockholders and officers are:

(a) voidable as a breach of fiduciary obligations owed the minority stockholders;

(b) voidable for lack of a "serious" consideration;

(c) voidable as a violation of Chapter 10(b) of the Securities and Exchange Act of 1934, Title 15, U.S.C.A. 78(j) and Rule X-10B-5, adopted by the Securities and Exchange Commission May 21, 1942.

Alleging that the corporation, acting through its officers, misrepresented facts, suppressed facts, exerted economic coercion and purchased the stock for less than one-fifth its value, respondents' action was grounded on fraud, constructive fraud, unjust enrichment, lack of serious consideration, mutual error, and violation of Chapter 10(b) of the Securities and Exchange Act of 1934, Title 15, U.S.C.A. 78(j) and Rule X-10B-5, adopted by the Securities and Exchange Commission May 21, 1942.

Respondents are residents of Louisiana and Arkansas and petitioner is a Delaware corporation with its only place of business in Louisiana. All facts pertinent to the purchase of respondents' stock occurred in Louisiana. All the stock was bought by the corporation in its name and with its funds.

After trial on the merits, to a judge without a jury, judgment was entered in favor of respondents as prayed for. The trial judge found that fraud had been proved, that facts had been suppressed thereby breaching the fiduciary obligations owed respondents, and that the consideration paid for the stock was not serious, within the meaning of that term as expressed in Article 2462 of the Civil Code of Louisiana. The other grounds of respondents' action were not passed on.

Upon appeal by the corporation to the United States Court of Appeals for the Fifth Circuit, that court affirmed the judgment. In its first opinion the Court of Appeals doubted that the "intent" element necessary as the basis for actual fraud was adequately established. The court held, however, that decision was correct and soundly predicated upon liability for breach of the fiduciary duty owed the minority stockholders. The court did not rule on the other grounds relied on by respondent for recovery.

In a second opinion, denying the corporation's petition for rehearing, the Court of Appeals held, upon further

consideration, that the proof was adequate to establish actual fraud, concluding its opinion in these words:

> "* * * we now hold that the necessary 'intent' had been established to constitute actionable fraud in Louisiana."(2)

The pertinent facts are as follows:

Mansfield Hardwood Lumber Company, petitioner, was a closely held corporation, the control of which had been largely inherited by the founder's second generation. Its principal assets were timbered lands and sawmills in North Louisiana. The minority stockholders, mostly aged individuals (one blind), were largely dependent upon petitoner's dividends for their livelihood. The Court of Appeals outlined the controlling facts as follows:

> "As the district court found, defendant's officers were the corporation. Other than their official nature, they were directors and also had in their control over one-half of the voting stock. They knew the intricate workings of the corporation, its total assets, and they knew more than the other stockholders about the value of the stock both for sale and upon liquidation. They used promises and representations as to their intended future running of the corporation which exerted economic influence on the plaintiffs, forcing them to sell, and then immediately began plans to liquidate in contradiction of their representations."(3)

The representations, the economic coercion and plans to liquidate in contradiction of their representations were found by the trial judge as follows:

> "While there were some unimportant differences in approach to the various minority stockholders, the general theme of the 'dividend squeeze', applied principally by Bud Johnson and Brown McCullough

(2) Appendix "K", page 148. Petition for Writ of Certiorari. 268 F 2d 317, 327.

(3) Appendix "J", page 124. Petition for Writ of Certiorari. 263 F 2d 748, 756.

during 1953, was to inform these people that the President and Second Vice-President were young men with children of their own and with long futures ahead in the business; that they wanted to avoid double taxation by paying themselves higher salaries and bonuses; that they intended to engage in an intensive reforestation program, together with capital improvements to the lumber mills, extending over a period of many years, during which there would be little or no dividends paid to stockholders and that these goals could be accomplished with the company's stock in the hands of the few persons constituting the majority. All minority stockholders were definitely assured that there was no plan for liquidation under consideration, and that none was contemplated for the future. The emphasis, instead, was upon 'Bud's and Tom's' desire and intention to make lifetime careers for themselves and their children, in operating the business as a going concern.' (4)

* * * * * * *

"* * * The ink was hardly dry on the papers representing the last minority stock purchase made on November 14, 1953, when he started out on the long-planned selling campaign." (5)

Further the Court of Appeals found that the following facts, known to petitioner's officers prior to the purchase of the minority stock, had not been disclosed to the minority stockholders:

"'1) The $5,000,000 offer, for 55% of defendant's timberlands, made by R. O. Martin to Bud Johnson in 1952;

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(4) Appendix "G", page 64, Petition for Writ of Certiorari, 159 F. Supp. 104, 111.

(5) Appendix "G", page 68, Petition for Writ of Certiorari, 159 F. Supp. 104, 114.

"'2) The instructions given to C. L. Brooke, in 1952, to assume that defendant's assets possessed a value in excess of $9,000,000;

"'3) The opinion of W. C. Postle, defendant's Chief Forester, in 1953, that its timberlands then had a market value 'in the neighborhood of a hundred dollars an acre', which the officers knew about;

"'4) The letters containing tax advice, written by Brooke on August 29 and October 14, 1952, wherein contemplated plans for sale of defendant's assets, liquidation, merger, stock sales, etc., were discussed;

"'5) The officers' secret consideration of various plans of liquidation, reorganization, merger, etc., before the stock-buying program was begun.'"(6)

Upon filing their complaint in the district court, the minority stockholders sought and obtained a restraining order and a preliminary injunction to prevent the corporation from completing the hurried distribution of its assets, including some 60,000 acres of mineral rights, to the remaining stockholders. Because the corporation sought to complete the distribution of its assets within one year after adopting a plan of liquidation, thereby avoiding certain taxes (26 U.S.C. 337(a)), at the suggestion of the court counsel for the corporation joined counsel for the minority stockholders in inquiring of the United States Department of Internal Revenue the effectiveness of various ways by which the tax might be avoided if the injunction did issue. In this connection, the trial judge observed:

"We are informed by all counsel, however, that a conference was held at Washington, D. C., on August 2, 1956, between plaintiffs' and defendant's counsel, on the one hand, and an official of the

(6) Appendix "J", page 123, Petition for Writ of Certiorari. 263 F 2d 748, 756.

United States Department of Internal Revenue, on the other, wherein the latter informally stated that the tax loss probably could be avoided if defendant's remaining assets are transferred to a Court-designated trustee as a stakeholder, with power to invest in short-term Government securities. We think application for a formal ruling to that effect by all means should be made at once, and when received, the transfer should be made."(7)

The application for a formal ruling was thereupon made by the corporation,(8) and a ruling was obtained(9) that if the remaining assets were transferred to a Court-designated trustee, by a stated date, the corporation would be "completely liquidated within one year after September 26, 1955." Then, in conformity with the ruling of the Internal Revenue Department, the remaining assets of the corporation were timely transferred to the Court's trustee to be held pending further order of the court.(10)

The corporation took an interlocutory appeal from the granting of this preliminary injunction and the Court of Appeals affirmed its issuance.(11)

ARGUMENT

Contrary to the statements contained in the Petition for Certiorari, both the District Court and the Court of Appeals found that the actions complained of constituted fraud per se. This case turns upon the correctness of factual things, and assumes importance only to the parties involved.

The Petition for Certiorari is based on statements concerning the opinions below some of which statements

(7) Appendix "A", page 30, Petition for Writ of Certiorari, 143 F. Supp. 826, 843.
(8) Record, page 1638.
(9) Record, pages 1506, 1624.
(10) Appendix "D", page 36, Petition for Writ of Certiorari.
(11) Appendix "F", page 43, Petition for Writ of Certiorari, 242 F. 2d 45.

are, in the opinion of respondents, incorrect and misleading. Respondents will point out some of them.

I.

Petitioner repeatedly states that the decision of the Court of Appeals was not based on a finding of fraud per se, for the Court of Appeals found, says petitioner, that the necessary "intent to deceive" had not been adequately established. For example, in footnote (1)A, page 3 of the petition, it is stated the Court of Appeals found after a careful review of all the evidence: "* * * that the corporation's officers had no fraudulent intent and that the factual findings of the District Court were 'clearly erroneous'* * *." Also on page 29 of the petition it is stated: "It will also be noted that the Court below in its second opinion on the merits, refusing a rehearing, did not reinstate the District Court's factual findings of actual fraud * * *."

These statements are at variance with the record and ignore the fact that in its second opinion the Court of Appeals said:

> "We initially expressed doubt that the defendant's officers were guilty of fraud per se because of our doubt that the naked 'intent to deceive' element was adequately established.
>
> * * * * * * * *
>
> "However, in view of our holding hereinafter that the district judge was not clearly erroneous in holding that the actions of appellant through its officers constituted actionable fraud under Article 1847, LSA — Civil Code, what has been said concerning the choice of laws to determine the duty owed by officers, directors, or majority stockholders to the minority shareholders may not be necessary for the disposition of this case. That is true because, as will be seen, the broad scope of fraud in Louisiana covers situations where the law imposes an obligation on the party with superior knowledge to disclose facts within his knowledge to the other and to

deal in an atmosphere of trust and confidence. Since appellant's officers had such superior knowledge, Louisiana fraud rules demanded open and disclosed dealings with utmost fairness

* * * * * * * * *

"* * * we now hold that the district court was not clearly erroneous in holding that the necessary 'intent' had been established to constitute actionable fraud in Louisiana."(12)

Accordingly, it is clear that the Court of Appeals agreed with the District Court's finding of fact that "intent to deceive" was established by the evidence and that actionable fraud was proved.

II.

Repeatedly throughout the Petition for Certiorari, and particularly on page 7 thereof, statements are made that the finding of fraud by the Court of Appeals was dependent upon a choice between the laws of Louisiana and Delaware to determine the duties owed by officers, directors or majority stockholders to minority stockholders.

Respondents cannot agree with these statements. In its second opinion the Court of Appeals held that the actions complained of constituted actionable fraud and that its opinion was not dependent upon what had been said concerning a choice of laws to determine the duty owed by officers, directors, or majority stockholders to the minority stockholders.

"However, in view of our holding hereinafter that the district judge was not clearly erroneous in holding that the actions of appellant through its officers constituted actionable fraud under Article 1847, LSA — Civil Code, what has been said concerning the choice of laws to determine the duty owed by officers, directors, or majority stockholders

(12) Appendix "K", pages 130, 137, 148, Petition for Writ of Certiorari, 268 F. 2d 317, 318, 322.

may not be necessary for the disposition of this case."(13)

III.

In footnote (1) C, on page 4 of the Petition for Certiorari, the statement is made that rescision of the stock sales "would admittedly invoke a tax loss of approximately $1,500,000.00." This statement is incorrect.

Throughout the Petition for Certiorari no reference is made to the formal ruling of the United States Department of Internal Revenue that:

> "* * * if all the remaining assets of your corporation, identified above, are transferred to a trustee, to be appointed by the Court, in pursuance of the pending suit of former stockholders against your corporation, and such assets are transferred to the trustee on or before September 25, 1956, it is held that your corporation will be completely liquidated within one year after September 26, 1955."(14)

Completion of liquidation by this date was the factor which determined that the tax referred to above would not be incurred. And it was this ruling of the Department of Internal Revenue which prompted the District Court to transfer the corporation's remaining assets to a court-appointed trustee. In this respect the Court of Appeals said in its opinion, upon the interlocutory appeal, affirming the issuance of the preliminary injunction:

> "* * * Appointing a custodial trustee and requiring the defendant, in compliance with the tax ruling obtained as a result of conferences between defendant's counsel, the court, and the tax officers, to convey to it its undistributed properties and thus complete its distribution in liquidation, — a liquidaton which for tax purposes had to be complete by September 25 1956, — the order appealed from not only secured the plaintiffs' position against loss pending the litigation of their claims but also

(13) Appendix "K", page 137, Petition for Writ of Certiorari. 268 F 2d 317, 322.

(14) Record, page 1509.

operated to save both plaintiffs and defendants from an enormous and wholly unnecessary tax loss, which might otherwise have occurred."(15)

IV.

At page 6 of the Petition for Certiorari the assertion is made that:

"* * * In an opinion refusing a new trial, the District Court admitted that its factual findings were erroneous in important respects but refused to reconsider the matter."

Petitioner attached to its motion for a new trial certain documentary evidence which it had not offered at the trial of the case. Rather than admitting "that its factual findings were erroneous" in overruling the motion for a new trial, the District Court said:

"We must regretfully conclude that the difference is merely one of degree, not principle. Moreover, this feature of the case was important only insofar as it corroborated our conclusion, on consideration of all evidence, that defendant's officers were guilty of overreaching. The additional 'evidence' submitted by defendant in support of this motion not only does not refute this conclusion, it actually reaffirms it, even if to a lesser degree.

* * * * * * * *

"Shortly restated, the simple, central facts were that all plaintiffs, except Max Brown, were pressured into selling their stock by the unconscionable 'dividend squeeze', applied by defendant's officers, and their false promises that there would be no liquidation. In such circumstances, we think equity demands the decision we have rendered, on which we must resolutely stand."(16)

V.

At page 30 of the Petition for Certiorari the statement is made that "the internal affairs of a corporation

(15) Appendix "F", page 48, Petition for Writ of Certiorari, 242 F. 2d 45, 48.

(16) Appendix "H", page 105, Petition for Writ of Certiorari.

are determined by the laws of the state of incorporation", and at page 14 of the petition it is stated that petitioner's stockholders "deliberately dissolved the Louisiana corporation in 1940 and obtained petitioner's charter in Delaware to obtain the advantages of Delaware corporation laws."

Respondents point out that the issue is not the internal management of the corporation; rather the issue involves fraud, overreaching and coercion by majority stockholders of a closely held family corporation. The question presented is whether purchases of stock from minority stockholders with corporate funds, and in the corporate name, can be rescinded as fraudulently induced when those purchases were accomplished by the officers and majority stockholders of the corporation using, as found by the Court of Appeals, "* * * promises and representations as to their intended future running of the corporation which asserted economic influence on the plaintiffs, forcing them to sell, and then immediately began plans to liquidate in contradiction of their representations."

Petitioners would like to give the impression that one of the "advantages" gained by its incorporation in 1940 under the laws of Delaware was the laws of Delaware permit majority stockholders to use the corporation and its funds to the detriment of the minority stockholders in the fashion done in this case. But the rule is universal that while the majority has the right to control the corporation, it occupies a fiduciary relation toward the minority; and the majority must exercise the affairs of the corporation and spend its funds in a good faith regard for the interests of the minority.

Zahn v. Transamerica Corporation, 162 F. 2d 36, CCA Third, 1946:

"The tenor of the federal decisions in respect to the general fiduciary duty of those in control of a corporation is unmistakable. The Supreme Court in

Southern Pacific Co. v. Bogert, 250 U.S. 483, 487, 488, 39 S. Ct. 533, 535, 63 L. Ed. 1099, said: 'The rule of corporation law and of equity invoked is well settled and has been often applied. The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors.' In Pepper v. Litton 308 U.S. 295, 306, 60 S. Ct. 238, 245, 84 L. Ed. 281, the Supreme Court stated: 'A director is a fiduciary. * * * So is a dominant or controlling stockholder or group of stockholders. * * * Their powers are powers in trust. * * *"

* * * * * * * * *

"See also Hyams v. Calumet & Hecla Mining Co., 6 Cir., 221 F. 529, 537, " * * * the rule, independently of state or national anti-trust statutes, is fundamental that one in control of a majority of the stock and of the board of directors of a corporation occupies a fiduciary relation towards the minority stockholders, and is charged with the duty of exercising a high degree of good faith, care, and diligence for the protection of such minority interests. Every act in its own interest to the detriment of the holders of minority stock becomes a breach of duty and of trust, and entitles to plenary relief from a court of equity. Jackson v. Ludeling, 88 U.S. 616, 21 Wall. 616, 624, 625, 22 L. Ed. 492; Jones v. Electric Co., 8 Cir., 144 F. at page 771, (Missouri Edison) 75 C.C.A. 631; Wheeler v. Abilene, etc., Bldg. Co., 8 Cir., 159 F. 391, 394, 395, 89 C.C.A. 477, 16 L.R.A., N.S., 892, 14 Ann. Cas. 917; 3 Clark & Marshall on Corporations, at page 2289.' See in particular Lebold v. Inland Steel Co., 7 Cir., 125 F. 2d 369. Cf. Lebold v. Inland S. S. Co., 7 Cir., 82 F. 2d 351.

"The law of the States in this respect is illustrated by such decisions as Singer v. Carlisle, Sup., 26 N. Y. S. 2d 172; Pearson v. Concord Railroad Corporation, 62 N.H. 537, 13 Am. St. Rep. 590; Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218, 17 L.R.A. 412; Bailey v. Jacobs, 325 Pa. 187, 189 A. 320; Lofland v. Cahall, 13 Del. Ch. 384, 118

A. 1. See also 19 C.J.S., Corporations § 764: 'The directors owe a duty of managing the corporate affairs honestly and impartially in behalf of the corporation and all the stockholders * * *."

Specifically, it should be observed that Delaware does not allow corporate officers and directors to use corporate money and facilities committed to their protection to bilk the shareholders to the profit of the officers and directors. The Supreme Court of Delaware has said:

Guth, et al v. Loft, Inc., 23 Del Ch. 255, 5 A. 2d 503 (1939):

"Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders.

* * * * * * * * *

"It is useless to pursue the argument. The facts and circumstances demonstrate that Guth's appropriation of the Pepsi-Cola opportunity to himself placed him in a competitive position with Loft with respect to a commodity essential to it, thereby rendering his personal interests incompatible with the superior interests of his corporation; and this situation was accomplished, not openly and with his own resources, but secretly and with the money and facilities of the corporation which was committed to his protection."

VI.

At page 27 of the Petition for Certiorari the opinion of the District Judge is characterized as "intemperate." Respondents are confident, however, that a reading of the District Judge's opinion on the merits will convince this court, as it did the Court of Appeals, that the District Judge was correct in his opinion.

It was the District Judge who saw and observed the witnesses on the stand. It was he who had to assess the integrity of petitioner's officers in light of their sworn

statements attached to the answer to the complaint. In these statements the president of the corporation said:

> "* * * that in connection with such purchase he made no misrepresentation to, nor did he withhold any information from, said complainants, or any of them, nor did he represent to said complainants, or any of them, that dividend payments would be virtually discontinued for a period of the next fifteen to twenty years as a consequence of the company's entering upon a long range plan of extensive reforestation and improvements of its assets, or for any other reason, nor did he agree with said complainants, or any of them, that the company would not sell its assets or liquidate, nor did he so represent to complainants, or any of them."(17)

The vice president said the same thing.(18)

It was the District Judge who had to decide the truthfulness of these statements and in light of the overwhelming evidence to the contrary, he did not believe them.

Respondents would also point out that the corporation's president and vice president swore in their pretrial deposition that, prior to commencement of the purchase of the minority's stock in February, 1953, liquidation of the corporation had not been "mentioned" or "discussed".(19) Nevertheless, it was proven on the trial of the case that these officers had in fact secretly considered "various plans of liquidation, reorganization, merger, etc., before the stock-buying program was begun" and had in fact sought and obtained "letters containing tax advice, written by Brooke on August 29 and October 14, 1952, wherein contemplated plans for sale of defendant's assets, liquidation, merger, stock sales, etc., were discussed."(20)

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(17) Record, page 54.
(18) Record, page 58.
(19) Record, pages 5 and 6.
(20) Appendix "J", page 123, Petition for Writ of Certiorari. 263 F. 2d 748, 756.

It was the District Judge who could best assess the credibility of the witnesses, the "dividend squeeze", the false representation as to the intended future running of the corporation, the concealed knowledge of the actual value of the corporation's assets, and the frantic efforts to liquidate the corporation begun when "* * * the ink was hardly dry on the papers representing the last minority stock purchase* * *."(21)

A reading of the District Judge's opinion on the merits will convince the court that the District Judge was completely correct in his appraisal of the facts. Such a reading will also clearly demonstrate that this case turns on its facts and presents no question of importance for the court to review.

CONCLUSION

The decision in this case turns upon its facts and is one of local interest only; it does not present any questions of "precedential value" and is "therefore outside of the criteria justifying a grant of certiorari." *Baker v. Texas and Pacific R. Co.*, No. 363 October Term, 1958, ... U. S. ....., 3 L. ed. 2d 756.

The result in the case is eminently correct. Respondents were induced by fraudulent representations to sell their stock to the corporation, as treasury shares, at a shockingly low price; they would not have sold except for the wrongful activity of the defendant's officers who con-

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(21) Under Rule 52(a) of the Federal Rules of Civil Procedure due regard "* * * shall be given to the opportunity of the trial court to judge of the credibility of the witnesses" and "Findings of fact shall not be set aside unless clearly erroneous* * *."

Bruce v. McClure, 220 F. 2d 330 (CCA 5th, 1955);
City of Orange v. F. & D. Co. 180 F. 2d 369, 370 (CCA 5th, 1950);

Scott v. Gearner, 197 F. 2d 93, 96 (CCA 5th, 1952);
Central Ry. Signal Co. v. Longden, 194 F 2d 310, 317, 318 (CCA 7th, 1952).

trolled the majority of the stock; they have been wronged and both the District Judge and the Court of Appeals have decided, after a thorough study of the record in the case, that plaintiffs are entitled to have the sales of their shares rescinded.

Sitting as a court of equity, appropriate orders were entered to preserve the rights of all parties without any adverse tax consequences. Plaintiffs are entitled to have the accounting, as ordered, without further delay.

Accordingly, it is respectfully submitted that the application for certiorari should be denied.

Respectfully submitted,

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PLICATION FOR REHEAR-
ING OF ORDER DENYING
PETITION FOR WRIT OF
CERTIORARI

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Office Supreme Court, U.S.
FILED
DEC 1 1959
JAMES R. BROWNING, Clerk

No. 371

Supreme Court of the United States

OCTOBER TERM, 1959

MANSFIELD HARDWOOD LUMBER COMPANY,
Petitioner

versus

HATTIE A. JOHNSON; JEANETTE JOHNSON JENNETTE; CORA HARREL, Administratrix of the Estate of Mamie E. Harrel; J. A. HARREL; ELIZABETH HARREL WALKER; RUTH HARREL MULKEY; MAX BROWN; ALICE S. H. BROWN; and DREW VELVIN, Executor of the Estate of Minnette Velvin,

Respondents

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

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LECOMTE, SHREVEPORT, LOUISIANA

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Respondents

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

Petitioner, Mansfield Hardwood Lumber Company, prays that this Court grant rehearing of its order of November 9, 1959, denying the petition for writ of certiorari, and that a writ of certiorari issue to review the judgment of the Court of Appeals for the Fifth Circuit in the above-entitled case as prayed for in the petition filed September 3, 1959, herein.

REASONS FOR GRANTING REHEARING AND ISSUING THE WRIT

The petition for writ of certiorari filed herein on September 3, 1959, was concentrated upon two important matters of national interest which petitioner considered to be decisive of the entire case — that the Court of

Appeals for the Fifth Circuit erred (a) in applying the laws of Louisiana to determine the validity of the internal affairs of a Delaware corporation and (b) in permitting this derivative-type action to proceed against the corporation as the only defendant without the alleged wrongdoing officers before the Court. Petitioner has other substantial grounds available which were not previously presented. Notwithstanding the doubt expressed by the Court of Appeals in its findings of fraud, litigation elsewhere with a resulting conflict of decision is improbable. The Court of Appeals itself recognized that this case has to be "viewed in the light of the civil law", peculiar to Louisiana, and that its decision is based upon "results which seem to common-law lawyers hard to obtain". *(Cf. Schriber-Schroth Co. v. Cleveland Trust Co., 305 U. S. 47, 50).* Indeed, a discussion of important issues applicable to the individual claims of several respondents was not previously presented.

1. Ben Drew Velvin, one of the respondents, was personally present in Court throughout the trial on the merits of this fraud case. When the case was with respondents, he did not take the witness stand. In fact, respondents had rested their case (R. 404) when petitioner called Mr. Velvin as a witness on cross-examination. The following is his own testimony (R. 731):

"Q. May I ask you, Mr. Velvin, just what are your contentions before the Court? **ARE YOU CONTENDING THAT THERE WAS FRAUD IN THIS CASE ON BEHALF OF THE OFFICERS OF MANSFIELD?**

A. **NO**, I don't think there is fraud.

Q. You don't think there was fraud?

A. **NO.**"

How could a judgment be rendered in favor of a litigant in a fraud action when the litigant himself testified that he is not contending that there was fraud? His

failure to take the witness stand would normally furnish a reasonable argument that he could not recover because the heavy burden rested upon him to prove fraud. This litigant not only failed to take the witness stand on his own behalf, but, after having heard all of the evidence presented by the other respondents, flatly testified under cross-examination that he is not contending there was fraud.[1] His claim alone, under the computations of the Courts below, involves an amount exceeding $100,000.00, being 51 shares at $2,068.00 per share. Simple justice dictates that the judgment in favor of Ben Drew Velvin should be reversed.

2. Max Brown, another respondent, is in a similar position. His own testimony on trial of the case is as follows (R. 433):

> "Q. Now, Mr. Brown, will you tell the Court in your own language just what false statement was made to you by anybody representing Mansfield before you agreed to sell and did sell that stock?
>
> A. *I don't know of any false statement that was made.*"

This is testimony from a respondent who was manager of one of petitioner's large lumber mills and was also one of petitioner's directors. He alleged that he was

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(1) Article 2291 of the Louisiana Civil Code provides, in part, as follows:

> "The judicial confession is the declaration which the party *** makes in a judicial proceeding. It amounts to *full proof* against him who has made it.

See also the decision of the Louisiana Supreme Court in *Barbour v. Barbour, 228 La. 823, 84 So. 2d 205, 207.*

Because the respondents' claims presented common questions of law and fact, joinder thereof was permitted in this case under the permissive joinder provisions of Rule 20, F.R.C.P. However, the burden rested upon each respondent to prove his own claims of fraud.

thoroughly familiar with the value of all of petitioner's assets and the value of his stock. The Trial Judge held as follows (R. 1313):

> "Max Brown is in a somewhat different position than the other plaintiffs, in that he knew defendant's stock was worth at least $2,000 per share, on a liquidation basis, when he sold his stock to the company."

Moreover, this litigant testified that on September 15, 1953, he attended a meeting of petitioner's board of directors and voted to approve the purchase by petitioner of his own stock (R. 423). On the same date, he attended the stockholders' meeting and again voted to approve the purchase of his own shares (R. 419). After selling his stock to petitioner, he continued to serve as one of petitioner's directors, with one qualifying share, and retained his job as manager of the lumber mill. On October 30, 1953, he voted both as a director and stockholder to approve the purchase by petitioner of the stock of other respondents (R. 426, 427). On September 26, 1955, he voted both as a director and stockholder in favor of the plan of liquidation of petitioner (R. 428, 429).

In view of the fact that Max Brown alleged and testified that he knew the value of petitioner's assets and the value of his own stock when he voted in favor of resolutions authorizing the purchase of his own shares, the judgment in his favor, predicated upon the breach of a fiduciary duty by petitioner's officers in failing to disclose facts affecting the values, is erroneous and should be reversed. How could petitioner be liable for the breach of a fiduciary duty to disclose when the litigant testified he was already fully aware of those facts? How could petitioner, a corporation, be guilty of fraud in the purchase of this litigant's stock when the litigant himself testified there was no fraud and voted both as a director and as a stockholder to approve resolutions authorizing such purchase?

The following findings appear in the opinions of the Trial Court:

"Max Brown's case is not as strong as that of the other plaintiffs'." (R. 1316)

"All plaintiffs, *except Max Brown*, were pressured into selling their stock." (R. 1342)

"His position in the case is not nearly as strong as that of the other plaintiffs." (R. 1343)

Although recognizing the weakness of this respondent's position, the Courts below placed him in a different category and found that he was subjected to "business duress". This finding is contrary to his pleadings and his own sworn testimony on trial of the case, as follows (R. 415):

"Q. Now, did you put that in your complaint that anybody coerced you to sell your stock?

A. No, sir. I didn't put that in my complaint."

On page 424 of the Record his testimony is as follows:

"Q. Nobody had suggested to you that your job depended upon your salary, had they? I mean your job depended on your stock?

A. No.

Q. Brown McCullough hadn't even intimated that your job and your stock went together?

A. No, sir.

Q. Isn't that a fact?

A. *That is a fact.*"

The holding that Max Brown was a victim of business duress is contrary to his own sworn testimony, unsupported by any pleading or evidence in this case. A judgment in his favor cannot be based upon the breach of a fiduciary duty to disclose facts with which he was

already fully familiar. He voted in favor of resolutions authorizing the purchase of his own stock by petitioner and testified that there was no fraud. His claim, under the computations of the Courts below, involves an amount exceeding $134,000.00, being 65 shares at $2,068 per share. The judgment in favor of Max Brown should be reserved.

3. Mrs. Hattie A. Johnson and Mrs. Jeanette Johnson Jennette, two other respondents, are in no better position. This action to rescind the contract of sale of their stock to petitioner was filed on June 22, 1956. Three days after their complaint was filed, on June 25, 1956, these respondents, with full knowledge of the fraud which they charged, elected to affirm the contract and fully executed it. They went to the bank and collected every penny remaining due under the terms of the contract, together with interest and a 2% call penalty. It is hornbook law that under such circumstances the contract could not thereafter be rescinded. However, these respondents have obtained a judgment in this case rescinding the same contract which they elected to affirm.

The contract for the purchase of the stock of Mrs. Johnson and Mrs. Jennette was in writing and appears in the Record on pages 52 to 80. The sale was on terms of $121,500 cash and the balance credit. The credit portion, $364,500, was secured by a mortgage on approximately 12,000 acres of timber owned by petitioner, and was represented by 20 equal promissory notes payable to Mrs. Johnson and 30 such notes payable to Mrs. Jennette, falling due at six months intervals. The mortgage required thirty days' written notice by petitioner of intention to call the notes prior to maturity and imposed a 2% call penalty. (R. 52-80).

As found by the Trial Judge (R. 1305), prior to September 26, 1955, Mrs. Johnson and Mrs. Jennette were contending that they had been defrauded and had

employed an attorney to assert their rights. With full knowledge of the fraud which they charged, these two respondents, on November 1, 1955, and again on May 1, 1956, surrendered and were paid for notes falling due on those dates (R. 54). On May 25, 1956, they were notified that all remaining notes would be called and paid at once, whereupon they required petitioner to give the thirty day written call notice (R. 533, 560, 561, and findings of the Trial Judge, R. 1308). Thereafter, *three days after this suit was filed*, they accepted payment of the balance due under the contract, including interest and a 2% call penalty. Moreover, they testified that they required full compliance by petitioner with its every obligation under the contract (R. 533, 561).

It is well-settled that a person, with knowledge of the facts which give him the right to rescind a contract on the grounds of fraud, must promptly elect to rescind and so notify the other party or lose the right of rescission. It is equally well-settled that a person, having elected to rescind the contract, must thereafter *adhere* to the position taken, otherwise he loses the right to rescind.

In *Shappiro, et al. v. Goldberg, 192 U. S. 232*, this Court said:

> "It is well settled by repeated decisions of this Court that where a party desires to rescind upon the ground of misrepresentation or fraud, he must, upon discovery of the fraud, announce his position and adhere to it. If he continues to treat the property as his own, the right of rescission is gone, and the party will be held bound by the contract. *Grymes v. Sanders*, 93 U.S. 55, 23 L. Ed. 798; *McLean v. Clapp*, 141 U.S. 429, 35 L. Ed. 804, 12 S. Ct. 29. In other words, when a party discovers that he has been deceived in a transaction of this character he may resort to an action at law to recover damages, or he may have the transaction set aside in which he has been wronged, by the rescission of the contract. If he chooses the latter remedy, he must act

promptly, 'announce his position and adhere to it', and not by acts of ownership continue to assert right and title over the property as though it belonged to him."

The doctrine of election of remedies in fraud cases is the same in Louisiana. *Porter v. Porter, 163 La. 167, 111 So. 664; Byrne v. Hibernia National Bank, 31 La. Ann. 81;* and *Dealers' Finance Company v. Woodard, 151 So. 145* (La. App.).

Mrs. Johnson and Mrs. Jennette admittedly reaped and retained the benefits due them under the contract for the purchase of their stock. They collected the greater portion of the purchase price three days after this suit was filed, with full knowledge of the fraud which they charged. In fact, after obtaining knowledge of the alleged fraud, they collected notes due under the contract on two separate occasions and required petitioner to give the thirty-day written notice of its intention to call the remaining notes. They elected to treat the contract as valid and subsisting and are not entitled to the judgment rescinding the contract which they affirmed.

The record also shows that Mrs. Johnson and Mrs. Jennette voted their stock in favor of resolutions authorizing the purchase by petitioner of the stock of other respondents (R. 548, 549, 472, 473). Thereafter, they solicited the purchase of their own stock by petitioner and were represented by an attorney when the written contract for the purchase of their stock was prepared and executed (R. 515, 557, 471).

Petitioner has repeatedly contended that, in view of the *undisputed* facts appearing in the Record of this case, Mrs. Johnson and Mrs. Jennette are bound by their election to affirm and execute the contract for the sale of their stock; that under the doctrine of election of remedies, they are not entitled thereafter to a judgment rescinding the sale. *Neither Court below has ever recog-*

nized that this defense was urged nor has it ruled thereon. Instead, both Courts have set forth findings concerning estoppel, waiver and ratification of fraud which do not answer petitioner's defense based upon election of remedies.

The claims of Mrs. Johnson and Mrs. Jennette, under the computations of the Courts below, involve an amount in excess of $2,500,000.00, being 1215 shares at $2,068 per share. Under fundamental hornbook law, they are not entitled to the judgment rescinding the written contract which they elected to affirm and fully executed three days after this suit was filed. The judgment in their favor should be reversed.

4. When the respondents sold their stock to petitioner as treasury shares in 1953, each respondent received at least $350.00 to $400.00 per share for his stock out of the corporation's surplus. The Record shows that at the time of these sales, the fair market value of this stock was only $320.00 per share (R. 679). Max Brown himself fixed the value at not more than $350.00 per share (R. 417). Although the Court of Appeals below recognized that this was the only evidence in the Record on the subject and found that all respondents received *more* than the fair market value of their shares *at the time of the sales*, it stated:

> "Had the plaintiffs and other minority sellers not sold their stock, *it would have been worth* about $2068 per share on liquidation."

The Court of Appeals below also found that the plan of liquidation of petitioner was not adopted until September 26, 1955, and that the sale of petitioner's assets in liquidation was not consummated until May 25, 1956. It is obvious that the Court fixed a value for the stock by simply dividing the total number of shares of the corporation in 1953 into the amount received in 1956 when the assets were sold in liquidation. It completely disregarded the fact that the respondents' stock was

minority shares; that an important change in Sections 331 (a) and 337 (a) of the Internal Revenue Code, which abolished the double capital gains tax in liquidation, did not become effective until August 16, 1954; and that the value of petitioner's assets increased during the intervening period of almost three years.(2)

It is well settled that the value of stock should not be determined simply by dividing the value of the corporation's assets by the total number of shares. *Williams v. Commissioner of Internal Revenue, 44 F. 2d 467, 470; Oxford Paper Co. v. United States, 52 F. 2d 1008; Hazeltine Corp. v. Commissioner of Internal Revenue, 89 F. 2d 513, 519.*

It is equally well settled in Louisiana that, in order to determine whether the parties suffered any loss in a fraudulent transaction, the fair market value of the thing sold must be taken *as of the date of the contract.* and not at some subsequent date. *Haas v. Cerami, 201 La. 212, 10 So. 2d 61, 63; Mann v. Edenborn, 199 La. 578, 6 So. 2d 667, 673; Harmon v. DeFatta, 182 La. 463, 162 So. 44; and Articles 1870 and 2590 of the Louisiana Civil Code.*

In holding that respondents' stock *would have been worth* more on subsequent liquidation of petitioner, which occurred almost three years after the stock sales took place, the Court of Appeals below not only came into conflict with decisions of the Louisiana Supreme Court on the subject but also came into conflict with decisions of this Court in *Sigafus v. Porter, 179 U. S. 116; Ithaca Trust Co. v. United States, 279 U. S. 151, 155; Gordon v. Butler, 105 U. S. 553; and Smith v. Bolles, 132 U. S.*

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(2) The Record shows that in 1952 the timberlands of Frost Lumber Industries were sold to Olin-Mathieson Chemical Corporation for only $65.00 per acre. (R. 254). Petitioner's timberlands were sold to the Robert Gair Company in 1956 at a price of $95.00 per acre.

125. In those cases this Court has held that it is the *fair market value of the property at the date of the sale* which controls, and not the amount the property would have been worth at some subsequent date if the fraud had not occurred.

Petitioner has repeatedly insisted that respondents suffered no loss in the sale of their stock because the Record shows that, in any event, they received more than its fair market value at the time of the sales. *Neither of the Courts below has ever recognized that this defense was urged nor has it ruled thereon.* The burden was upon respondents to show, by strong and conclusive evidence, that they suffered some loss in the transaction and that they did not receive the fair market value of their stock *at the time of the sales.* Having failed in this respect, the judgment in their favor should be reversed.

5. The foregoing illustrations, based entirely upon the sworn testimony of several of the respondents themselves and upon uncontroverted facts which were stipulated and referred to in the opinions of the Courts below, clearly demonstrate that this case was not correctly decided. Application of fundamental legal principles to the testimony and admitted actions of Ben Drew Velvin, Max Brown, Mrs. Hattie A. Johnson and Mrs. Jeanette Johnson Jennette should have resulted in the rejection of their claims in the Trial Court, thereby disposing of approximately 85% of the entire claims asserted in this case. Instead, the Trial Judge rendered lengthy opinions setting forth findings of fact "based upon what we believe to be the truth, notwithstanding some testimony to the contrary" and upon "inferences which we believe to be reasonable and correct" (R. 1262). In summation, at page 1342 of the Record, he found:

> "Shortly restated, the simple, central facts were that all the plaintiffs, except Max Brown, were pressured into selling their stock by the unconscionable

'dividend squeeze' applied by defendant's officers, and their false promises that there would be no liquidation."

With reference to the "dividend squeeze", the Trial Judge found that petitioner's officers had organized a "phantom firm", known as Shreveport Lumber Sales, through which they skimmed off approximately $135,000 annually from petitioner's income; that they drew excessive salaries; that they had expense accounts which "undoubtedly were handsome"; and that they "probably" bought a large amount of timber from outside sources, instead of cutting from petitioner's timberlands, in order to maintain their value for purposes of later liquidation. These findings are unsupported by and directly contrary to the facts appearing in the Record of this case.

With reference to the officer's promise that the corporation would never be liquidated, it is obvious that such a promise by the officers, if made, could not bind petitioner, the corporation. A promise by an officer not to liquidate is against public policy and unenforceable by either party to the agreement. *Mumma v. The Potomac Co., 33 U. S. 281, 287; West v. Camden, 135 U. S. 507;* and *Schleider v. Diclman, 44 La. Ann. 462, 469, 10 So. 934.* Statements promissory in nature and relating to future dividends or liquidation of a corporation do not constitute actionable fraud in Louisiana *Farmers Loan & Mtg. Co. v. Langley, 166 La. 251, 117 So. 137; Green v. La. Highway Comm., 5 So. 2d 236; Brinker v. Feist, 14 La. App. 101, 129 So. 416; Brenard Mfg. Co. v. Gibbs, 4 La. App. 312; 9 La. App. 137, 119 So. 483.*

Moreover, on appeal petitioner obtained a complete reversal of the factual findings which formed the basis of the judgment of the Trial Court. In no uncertain terms, the Court of Appeals below reversed the findings of the Trial Judge in the following language: (263 F. 2d 748, 757-758)

> "We do hold that the trial court was *clearly erroneous* in its findings as to the Shreveport Lumber Sales, in commenting on the excessiveness of the officers' salaries and expense accounts, and in holding 'that the officers probably bought a large amount of timber from outside sources, instead of cutting from defendant's timberlands, thus maintaining their value for purposes of future liquidation', all found at 159 F. Supp. p. 111. *In fairness to defendant's officers, we record our opinion that such findings are clearly erroneous.*"

In addition, the Court of Appeals below squarely reversed the Trial Court in its findings of actual fraud, to the extent that it considered it unnecessary to consider petitioner's defenses in his case, with the following statements: (26 F. 2d 748, 753-754)

> "We feel it unnecessary to dwell upon these contentions because, *after carefully studying all of the evidence in this cause*, we are of the opinion that the district court was *clearly erroneous* in finding that fraud per se of defendant through its officers was established ***"

Notwithstanding its holding that the facts found by the Trial Court were clearly erroneous and unsupported by the Record,(3) and notwithstanding its holding that the

(3) The brief summary of facts found by the Court of Appeals below, 263 F. 2d at page 752, was equally erroneous.

It found that "The defendant purchased a total of 1,567 shares." At pages 92 and 93 of the Record it is clearly established, *by joint stipulation of the parties*, that petitioner purchased a total of 1829 shares.

It found that "Robert Gair Company, Inc., had agreed to purchase *all the assets* of defendant, excepting certain mineral rights, for *$9,531,630.34*", which "was consummated on May 25, 1956." At page 94 of the Record it is clearly established, *by joint stipulation of the parties*, that petitioner's timberlands were sold to Robert Gair Company, Inc., for $8,632,530.34, and that other substantial assets were sold to Hunt Lumber Company, Olin-Mathieson Chemical Corporation, and others.

It found that petitioner's "three officers — A. S. (Bud) Johnson, Brown McCullough, *and T. W. M. Long*—"

Trial Court was clearly erroneous in holding that actionable fraud of petitioner through its officers was established, because the "intent" element necessary as the basis for actual fraud was not established, the Court of Appeals below affirmed the judgment against petitioner by applying the common law doctrine of *constructive* fraud. It found that a breach of fiduciary duties by petitioner's officers, which does not exist in a majority of jurisdictions in this country, furnished the basis for the imposition of a "constructive trust" or "equitable lien" on petitioner's property.

Petitioner alone filed an application for rehearing wherein it pointed out that under the laws of Delaware, petitioner's State of incorporation, no fiduciary duty is imposed upon corporate officers in purchasing the stock of individual stockholders; that constructive fraud is impossible in Louisiana because "intent" is an essential element of fraud under the provisions of the Louisiana Civil Code; and that the Louisiana civil law prohibits the imposition of a constructive trust or equitable lien on property.

Once again, petitioner obtained a complete reversal in this case — this time upon the entire legal reasoning which formed the basis for the opinion of the Court of Appeals below. After stating that "We will attempt to clarify and correct *the basis* for our holding", the Court of Appeals below flatly held that " 'constructive fraud', found in the law of fiduciaries and characterized by the lack of the 'intent to defraud', is *impossible* under Article

were majority stockholders. At page 92 of the Record it is established by the same stipulation that T. W. M. Long owned ***only 7 shares*** of stock. In addition, T. W. M. Long was never charged with fraud by any respondent (See Article 28 of the complaint, R. 1371).

At page 750, it was held that "***six people*** proceeded to sell and liquidate the corporate assets". The same stipulation (R. 90-96) shows that petitioner's remaining ***twenty-four*** stockholders adopted the plan of liquidation.

1847" of the Louisiana Civil Code. It also held: "We agree with appellant (petitioner) that the Louisiana Civil Law prohibits the imposition of a constructive trust or equitable lien on property," and that "the equitable remedies of constructive trust or equitable lien are alien to the civil law". In addition, the Court of Appeals below held that Delaware imposes no fiduciary duty on the part of officers in buying stock from individual stockholders; that the Delaware law in this connection follows the majority rule in this country; and that, under the general law in this country as set forth in the decision of this Court in *Rogers v. Guaranty Trust Co., 288 U. S. 123, 130,* and decisions of the Courts of Appeals for the Second, Third and District of Columbia Circuits listed in footnote 6 of its opinion, the conflict-of-laws rules of the forum require that court to refer to the law of the State of incorporation (in this case, Delaware) to determine the extent and nature of the relationship between officers and stockholders of a corporation. It further held that if it applied the laws of Delaware, petitioner's State of incorporation, and if it complied with the general conflict-of-laws rule in this country, the judgment in this case would be in favor of petitioner.

However, despite the fact that no application for rehearing had been filed by respondents to review the factual findings of the Trial Court, and without affording petitioner an opportunity to be heard, the Court of Appeals below rendered an opinion refusing a rehearing and said:

> "We now hold that the district court was not clearly erroneous in holding that the necessary 'intent' had been established to constitute actionable fraud in Louisiana."

This conclusion of the Court below was arrived at by a complicated analysis of Louisiana law to produce "results which seem to common-law lawyers hard to

obtain under a literal interpretation of the (Louisiana) Civil Code."

Petitioner's attorneys, who are trained in the civil law, categorically state that the results in this case are *impossible* under any interpretation of the Louisiana Civil Code. As stated above, the Court of Appeals below, in this same opinion, held that " 'constructive fraud', found in the law of fiduciaries and characterized by the lack of the 'intent to defraud', is *impossible* under Article 1847" of the Louisiana Civil Code. "Constructive fraud" is a doctrine of some of the common-law States whereby fraud may be found from a mere breach of fiduciary duties and without any actual intent to defraud. That doctrine is impossible in Louisiana, where "intent" is an essential element of fraud, and where fraud may not be inferred from a mere breach of fiduciary duties.

Equally erroneous is the method whereby the Court of Appeals below decided to apply the law of Louisiana, the forum, to determine the nature and extent of fiduciary duties between officers and stockholders of petitioner, a Delaware corporation. It stated:

> "Those decisions (listed in footnote 6, *supra*) are, however, in our opinion, either inapplicable or unsound where the only contact point with the incorporating state is the naked fact of incorporation, and where all other contact points, such as, residence of parties and actors, situs of property, lex loci delicti or contractus, place where corporation is conducting its only or principal place of business, et cetera, are found in another jurisdiction. *** When, however, the situation is such as here, and *all* contact points are in the forum, we believe that the laws of the forum should govern." (Italics by the Court)

In addition to the fact that the Court of Appeals below has indicated that the decision of this Court in *Rogers v. Guaranty Trust Co.*, *supra*, and decisions of

the Second, Third and District of Columbia Circuits, listed in its footnote 6, are unsound, if applied to this case, the Court below is in error in finding that "*all*" contact points are in Louisiana, the forum. The Record in this case shows that in 1953, when the sales took place, petitioner's outstanding stock was in the hands of 38 stockholders residing in Arkansas, Texas, Indiana, New York and Connecticut, as well as Louisiana. The District Judge found that it had acquired retail outlets and lumber yards in five towns and cities in Louisiana, Arkansas and Texas, as well as 100% of the stock of Reader Railroad, operating between Waterloo and Reader, Arkansas, and of two subsidiary corporations, Mansfield Hardwood Lumber Company of Texas, and Louisiana Builders Supply (R. 1265). It was authorized to do and doing business in Arkansas, Texas and Louisiana, and sold its products throughout the entire United States. As required by Section 131 of the Delaware Corporation Law, it maintained its principal office in Delaware. Respondents, in their complaint itself (R. 1362 through 1387), allege that they are citizens of Arkansas and Louisiana and that they were contacted by petitioner's officers with reference to the sales in Lewisville, Arkansas. Other stockholders, who did not sell, were contacted in New York City and in Texas, as well as Louisiana. The District Judge found that, after the sales, some of petitioner's remaining twenty-four stockholders "live outside Louisiana, as far away as New York City and Mineral Springs, Texas." (R. 1467).

Accordingly, the "grouping of contacts" theory, adopted by the Court of Appeals below to justify application of Louisiana law to determine the relationship between officers and stockholders of a Delaware corporation, cannot be applied under the facts appearing in the Record of this case. The Court was clearly erroneous in holding that *all* contacts were in Louisiana, such as residence of the parties, situs of property, place of contract-

ing, place where the corporation "is conducting its only or principal place of business, et cetera".

In summary, therefore, petitioner emphasizes the fact that it has obtained a complete reversal of the factual findings of the Trial Judge, with an opinion from the Court of Appeals squarely holding that the factual findings which formed the basis of the opinion of the District Court on the merits were clearly erroneous and that the District Judge was clearly erroneous in finding that actual fraud of petitioner through its officers had been established. Although the Court of Appeals below affirmed the judgment by applying the common law doctrine of constructive fraud, on rehearing petitioner obtained a complete reversal of the legal theories which formed the basis of that Court's opinion. However, after correcting its admitted error, the Court of Appeals below, without affording petitioner an opportunity to be heard, apparently reverted to factual findings of the District Court which it had previously held, "after carefully studying all of the evidence in this cause", to be "clearly erroneous" and unsupported by the Record in this case. In fact, as stated above, the Court in its previous opinion, by repetition and at the conclusion thereof, had stated:

> "*In fairness to defendant's officers*, we record our opinion that such findings are clearly erroneous **."

The District Judge himself held that petitioner's officers are "educated, cultured and refined", who "have enjoyed, and still occupy, positions of prestige in their home communities", and who "are men of acumen and integrity". (R. 1258 and 1285). In fairness to these officers, petitioner urges this Court to exercise its supervisory powers and review the decision of the Court of Appeals below. If there be a finding of fraud, petitioner is entitled to a correct factual statement thereof based upon the evidence appearing in the Record of this case. On the other hand, if the decision is predicated upon the

breach of fiduciary duties by petitioner's officers, which admittedly do not exist under the laws of petitioner's home state, it is in direct conflict with the recent decision of the Court of Appeals for the Seventh Circuit in *James Blackstone Mem. Lib. Ass'n. v. Gulf, M. & O. R. CO., 264 F. 2d 445*, wherein it is held that: even in the minority jurisdictions, there is no duty upon corporate officers to disclose their desire or hope to sell corporate property, nor even the fact that the possibility of a sale exists. The facts in the present case fall far short of the "assured sale" situation discussed in that case.

The District Judge, in his opinion on the merits, held that "as strong a proof as any other evidence before us that these officers had meant to defraud the minority from the beginning" was the failure of petitioner's officers to tell the respondents: "We want you to come back into the company, for there is more than enough for everyone to share." This statement of the philosophy applied by the District Judge in his decision in this case, which apparently was approved by the Court of Appeals below, is not a firm basis upon which to rest a judgment against petitioner in this fraud action.

This case was not only decided upon erroneous findings of both fact and law, but, as pointed out in petitioner's petition for a writ of certiorari, involves matters of national concern. The method whereby the Court of Appeals below applied the laws of Louisiana, the forum, to determine the nature and extent of fiduciary obligations between the officers and stockholders of a Delaware corporation is in direct conflict with decisions of this Court and the Courts of Appeals for the Second, Third and District of Columbia Circuits referred to in the opinion. A correct decision on this conflict-of-laws question is of paramount importance to every corporation in this country, particularly those incorporated under the laws of Delaware. The decision is in direct conflict with the Louisiana conflict-of-laws rule which provides that the validity of in-

ternal affairs of a foreign corporation must be determined by the laws of the state of incorporation. On jurisdictional points, the decision is in direct conflict with decisions of this Court which hold that, in this derivative-type of action, the alleged wrongdoing officers are indispensable parties and the action cannot proceed against the corporation as the only defendant. In addition, as reflected by the vacillation of the Courts below in their decision upon every question of law and fact, it appears that they have so far departed from the usual and accepted course of judicial proceedings as to call for an exercise of this Court's power of supervision.

CONCLUSION

For the reasons set forth above and in the petition for writ of certiorari, it is respectfully urged that rehearing be granted, and that, upon such rehearing, a writ of certiorari issue to the Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 58 of the rules of this Court.

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